SPECIAL ISSUE ON CHINA'S REFORM TASKS

The Economist

MARCH 25TH-31ST 2006 www.economist.com

Scant optimism in Iraq
PAGES 49-51

Ben Bernanke's Fed
PAGES 12 AND 77

Israel's predictable election
PAGES 14 AND 27-28

Phoney revolution in France
PAGES 12 AND 53

How to make China even richer

ONLINE FEATURES

Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers

GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

The Economist Group
Economist Intelligence Unit
Economist Conferences
The World In
Intelligent Life
CFO
Roll Call
European Voice

Print Edition March 25th 2006

On the cover
China's Communist leaders are worried about inequality between town and country. They should let the peasants own their land: leader

Previous print editions

Mar 18th 2006
Mar 11th 2006
Mar 4th 2006
Feb 25th 2006
Feb 18th 2006

More print editions and covers »

Subscribe

Subscribe to the print edition
Or buy a Web subscription for full access online
RSS feeds
Receive this page by RSS feed

The world this week

Politics this week
Business this week

Leaders

China
How to make China even richer

Central banks
Running on M3

European economies
Europe inside out

Britain's budget
The chancellor who would be prime minister

Israel's election
The remarkable survival of Kadima

Letters

On India, the National Health Service, William Wilberforce, corruption, Nelson Mandela, organs, underwear

Special Report

Israel's new politics
Shutting itself in, hoping for the best

United States

Foreign policy
How to go global

Black Republicans
Are there any?

Political appointments
Mr Kempthorne goes to Washington

The Illinois governor's race
Punches and Judy

New York schools
Pennies from heaven

The potato industry
Pass the spuds

Lexington
The battle of ideas

The Americas

Peru
At the double, Ollanta the outsider

Ecuador
Pre-electoral tension

Jamaica
Portia's turn

Corruption in Brazil
House calls

Mexico's postal services
On Mexican time

Asia

Bangladesh and India

A survey of China

Coming out
Fat of the land
A piece of the action
Keep growing
Good things in tiny packages
Pride and prejudice
No time like the present
Sources and acknowledgements
Offer to readers

Business

Whistleblowers
Tales from the back office

Ethical business
The body beautiful

Photography
Down with the shutters

China
A new train set

Foreign investment in Russia
An enemy of the people

Wine
Sweet taste of success

French economic nationalism
Colbert was here

Face value
A healthier addiction

Special Report

The logging trade
Down in the woods

Finance & Economics

Central banking (1)
Bernanke ponders his course

Central banking (2)
The Issing link

The Quattrone case, cont'd
Frank's new friends

The rupee
Fear of freedom

Investment banks in India
Gold rush

Insurance
The pursuit of Prudence

Economics focus
Push and pull

EuroFinance Conferences
Economist Diaries and
Business Gifts

Advertisement

A problem shared

Nepal
Off his head

Japan
Koizumi's last days

Singapore
Self-replicating

Middle East & Africa

Iraq
Murder is certain

Press freedom in east Africa
Hear no evil

War crimes
Bad news for Africa's warlords

Europe

French protests
The phoney revolution

Spain and ETA
Peace talk

Belarus's election
A dictator dictates

German state elections
The politics of shrinking

Italy
Sicilian vespers

Turkey's cultural heritage
Topkapi capers

Charlemagne
Back to school

Britain

The budget
Head to head

Political parties
Going, going, gong

Inequality
Closing gaps

Gordon Brown and the economy
Lustre lost

Christian activists
Linking souls across the sea

Teaching reading
Fast, first—effective?

The Royal Shakespeare Company
Going east

Bagehot
A broken system

Articles flagged with this icon are printed only in the British edition of *The Economist*

Science & Technology

The scientific method
Computing the future

Cosmology
MAP-ping the universe

Mobile phones
A text a day...

Zoology
On the one hand

Books & Arts

Civil liberties
Thinking for freedom

American foreign policy (1)
Point men

American foreign policy (2)
Money talks

London's Bankside
The city's other shore

The return of Sidney Lumet
An old maestro

Michelangelo's drawings
Heaven on earth

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Job vacancies

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Official reserves

Emerging-Market Indicators

Overview

Exchange rates against the dollar

Economy

Financial markets

Advertisement

Classifieds

Jobs
Non Executive Director for DFID's Human Resource Committee
Non Executive Director post for DFID's Human Resource....

Business / Consumer
WSI Internet - Start Your Own Business
Business Opportunity - WSI Internet Start Your Own Busines....

Jobs
Executive Director
The Ross Institute for Advanced Study and Innovation in Education
EXECUTIVE DIRECTOR ....

Jobs
Chief, Evaluations and Performance Audit Service
The World Meteorological Organization (WMO), based in Geneva, ...

Jobs
Training Co-ordinator (Part-time)
Based: London A vacancy has arisen for a Training Co-ordinator to provide an eff....

Jobs
Manager - Performance, Strategy & Evaluation
MANAGER PERFORMANCE, STRATEGY & EVALUATION The Global....

Sponsors' feature About sponsorship »

Copyright © The Economist Newspaper Limited 2006. All rights reserved. Advertising Info | Legal disclaimer | Accessibility | Privacy policy | Terms & Conditions | Help

Proudly Presented by =nEo=

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Politics this week

Mar 23rd 2006
From The Economist print edition

American and British forces freed three hostages held in **Baghdad** since November. Norman Kember, a Briton, and James Loney and Harmeet Singh Sooden, both Canadians, belong to a Christian peace-group working in Iraq. Their detention was condemned by Muslims worldwide. The tortured body of a fourth hostage, Tom Fox, an American, was found in Baghdad earlier this month.

AFP

George Bush used a press conference to re-emphasise that he thinks his policy in Iraq will eventually produce a democratic country. He also hinted that a decision to bring American troops home would be made by his successor, after January 2009.

Illinois held primaries for November's mid-term elections. Tammy Duckworth, one of the most prominent of several Iraq war veterans who are campaigning across the United States, won her Democratic primary. See article

An appeals court dismissed revised federal regulations that attempt to loosen **emission controls** for older coal-powered energy plants. The case had been brought by 15 states, including California and New York, which argued that the looser rules, issued in 2003, harmed public health.

Perilous apostasy

Western governments expressed concern over religious freedom with **Afghanistan's** government following the jailing of a man (who may yet be executed) for converting from Islam to Christianity.

Afghanistan's president, **Hamid Karzai**, reshuffled his cabinet and replaced Abdullah Abdullah as foreign minister. Mr Abdullah was the last significant member of the Northern Alliance, which fought the Taliban in the 1990s, left in the cabinet.

Sonia Gandhi, leader of **India's** ruling Congress party, resigned her seat in India's parliament, and as chair of a national advisory commission. Members of parliament are not allowed to hold other paid public positions. Congress's reported plans to amend this rule, seen as a move to protect Mrs Gandhi, had caused a furore. She says she will stand for re-election in her constituency.

Russia's president, Vladimir Putin, paid a visit to **China**, where a number of deals were signed, including an agreement to build pipelines that will eventually provide China with up to 80 billion cubic metres of gas a year. See article

AP

The Minsk wail

As expected, Alyaksandr Lukashenka was declared the overwhelming victor in **Belarus's** presidential election. Protesters demonstrated on the streets of Minsk against what they saw as a rigged result, but a repeat of Ukraine's “orange revolution” of last winter looks unlikely. See article

Silvio Berlusconi attacked Italian businessmen at a conference organised by Confindustria, a business lobby group. The Italian prime minister, who is lagging in the polls ahead of next month's election, said that those who supported the left were out of their minds. He also suggested that the idea of Italy being in an economic crisis had been dreamt up by the left and by the newspapers.

In **France**, street protests continued to grow against a new job contract that would make it easier to fire the young. The prime minister, Dominique de Villepin, is refusing to back down, though he is talking of offering some concessions. See article

The Basque separatist group **ETA** announced a “permanent ceasefire”. ETA has killed over 800 people in the past 40 years, though nobody during the past three. Its ceasefire was welcomed by Spain's prime minister, José Luis

By nEo

Rodríguez Zapatero, who has been more open than his predecessors to dialogue with Spanish regions seeking more autonomy. See article

The trial began in Britain of seven men, allegedly linked to **al-Qaeda**, who conspired to launch a campaign of bombings. One defendant was accused of trying to buy a “radioisotope bomb”.

Sweden's foreign minister, Laila Freivalds, resigned after allegations that she lied about her involvement in the closure of a Swedish website that wanted to publish cartoons of the Prophet Muhammad.

Unknown soldier

Prices of **Peruvian** bonds and shares fell as opinion polls suggested that Ollanta Humala, a nationalist former military officer of no previous political experience, might win the first round of a presidential election on April 9th. See article

Ecuador's government imposed a state of emergency in five highland provinces after protests by Indian groups, partly against free-trade negotiations with the United States and partly aimed at extracting extra public spending ahead of an election in October. See article

Pressure mounted on **Brazil's** finance minister, Antonio Palocci, after claims by witnesses that he was a frequent visitor to a house in Brasília used as a lobbying centre in 2003 and 2004, something which he has previously denied. In a long-running corruption scandal, Brazil's ruling Workers' Party is alleged to have made illegal donations to allied parties and bribed congressmen. See article

Argentina's government took control of Aguas Argentinas, a company partly owned by France's Suez that provided water and sewerage in Buenos Aires under a 30-year contract. Suez earlier said it would forgo the contract because of a government tariff freeze.

A banker for Benin

AFP

Yayi Boni, a former banker, was elected the new president of the west African state of **Benin**. He beat his nearest rival, Adrien Houngbedji, in a run-off election on March 19th.

Heavy fighting broke out in the Somali capital, **Mogadishu,** between militia groups and an armed Islamist group, killing at least 20 people. It is a setback for the anarchic country, whose parliament met only recently on home soil for the first time in over a year.

Kadima, the party founded by Ariel Sharon, is leading its rivals in the run-up to **Israel**'s general election on March 28th. Now led by Ehud Olmert, it is expected to be the biggest party in Israel's next coalition government. See article

Iran's supreme spiritual leader, Ayatollah Ali Khamenei, said he supported talks with America on the instability in Iraq. Some conservatives in Iran's government had opposed negotiations. He also reiterated Iran's right to pursue what it insists is a peaceful nuclear energy programme.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Business this week

Mar 23rd 2006
From The Economist print edition

General Motors reached an agreement on early retirement with the United Auto Workers, boosting the carmaker's cost-cutting programme. The deal should also avert a strike by workers at **Delphi**, GM's bankrupt parts supplier, who are included thanks to commitments made when GM span the firm off in 1999. The news was welcomed by investors. Last week, the carmaker revealed that its loss of $10.6 billion for 2005 was $2 billion more than reported in January, largely because of its exposure to Delphi.

Volvo Trucks gained a foothold in Asia by buying a 13% stake in **Nissan Diesel** from Nissan Motors for SKr 1.5 billion ($195m). The Swedish company has an option to buy the remaining 6% of Nissan Motors' stake within the next four years.

Sanofi-Aventis, a French pharmaceutical company, settled a dispute with **Apotex**, a Canadian maker of generic drugs, which protects Sanofi's American patent on Plavix, a blood-thinner, until 2011. Sanofi's share price soared after the announcement; Plavix, marketed by Bristol-Myers Squibb, is the world's second bestselling drug.

A Vista on the horizon

Microsoft delayed the consumer launch of its new Windows **Vista** operating system (again), pushing the date to January. The share prices of some computer-makers wobbled at the news. Investors fretted that sales might stall in the Christmas season as shoppers wait for the new version.

After the group's chief executive said he had “no plans” to do so, **Aviva** was forced by British regulators to admit it might still raise its offer of around £16 billion ($30 billion) for **Prudential. Aviva** says that its bid, which would unite Britain's two biggest insurance companies, promises advantages when competing with larger American and European firms. The Pru has rejected the offer. See article

ITV, Britain's biggest commercial broadcaster, turned down a proposal by three private-equity firms seeking a controlling interest in the company. The consortium includes Apax Partners, which retains Greg Dyke, the BBC's former director-general, as an adviser.

Body Shop International is to be bought by **L'Oréal** for £652m ($1.1 billion). Anita Roddick, who founded the beauty retailer, said L'Oréal's French negotiators were “the most bloody seductive people on earth”. Some questioned whether Body Shop's earthy-crunchy image will fit with the owner of such glamorous brands as Lancôme.

Following a precedent

A federal appeal court ordered a retrial of **Frank Quattrone**,an investment banker made rich by the 1990s tech boom, who was convicted in 2004 of obstructing justice. In similar thinking to last year's Supreme Court's ruling that overturned Arthur Andersen's conviction, the court found fault with instructions given to the jury at Mr Quattrone's trial. The judge had not made it clear that to secure a conviction he had to be found to have knowingly obstructed an investigation into share dealings when he asked colleagues to wipe e-mails. See article

Chen Jiulin, the former chief executive of **China Aviation Oil**, was sentenced by a court in Singapore to four years in jail for his part in a $550m derivatives scandal in 2004. Mr Chen pleaded guilty last week to six charges that included issuing false financial statements. Several former executives have been sentenced in the case, which was Singapore's biggest financial scandal in a decade.

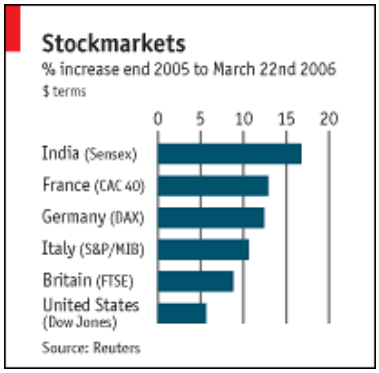
PetroChina reported net income of 133.4 billion yuan ($16.3 billion) for 2005. The profits were larger than those made by firms such as Total and Chevron, and are the biggest-ever for an Asian publicly listed company (which is a subsidiary of state-run CNPC).

BAA rejected an £8.75 billion ($15.4 billion) preliminary takeover offer from **Grupo Ferrovial**, a Spanish firm which specialises in infrastructure and which has been mulling a bid for the British airports operator since February. Britain's regulators gave Ferrovial until April 24th to make a firm offer.

SITA, a firm which provides IT systems to airlines, estimated that **missing luggage** will cost the industry $2.5 billion this year. Most of the 30m stray valises will be returned, eventually, to their rightful owners, but 204,000 bags (out of three billion that are checked in) will be lost for ever.

That frothy feeling

Stockmarkets continued the year's bullish run. The FTSE index closed above 6,000 for the first time in five years and the **Dow Jones Industrial Average** traded over 11,000. The star performer was the **Bombay Stock Exchange's Sensex index**, which touched 11,000 for the first time, just six weeks after topping 10,000.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

China

How to make China even richer

Mar 23rd 2006
From The Economist print edition

Let the peasants own their land

ROPI

Get article background

IN 1940, nine years before his Communist Party seized power, Mao Zedong set out his plans for a “new China”. The republic would, he said, “take certain necessary steps” to confiscate land from rural landlords. Under the principle of “land to the tiller”, it would then “turn the land over to the private ownership of the peasants.” If only things had turned out this way.

The “necessary steps” involved widespread slaughter. Hundreds of thousands, maybe millions, of landowning rural residents and their families were executed or beaten to death by fellow villagers. The peasants got their small parcels of land, but not for long. By the late 1950s, private land ownership had been eliminated and peasants had become property-less members of “People's Communes”. It was an upheaval that, along with bad weather and a frenzied attempt to catch up with American levels of industrial production, contributed to millions more deaths in a nationwide famine.

As our survey describes, China has yet to undo the damage. A few years after Mao's death in 1976, the People's Communes were dismantled. Under Deng Xiaoping, agricultural production soared as for the first time in 30 years peasants were allocated (but not given full ownership of) plots of land to farm independently. This marked the start of the economic transformation that today holds the world spellbound. But it is the prosperity of urban China that mesmerises foreign businesses. Since its boom in the early 1980s, the countryside has lagged ever further behind.

This time, a genuine great leap forward

Deng kept in place two pillars of the Maoist rural order: collective land ownership and an apartheid system that barred rural residents from moving to the cities. The latter has begun to erode, due to the need for cheap labour to sustain a manufacturing boom. But the former remains firmly in place.

Now is the time to revive Mao's vision of a new landowning order. This would ease rural strife, fuel growth and help develop the genuine market economy the leadership claims to want. Giving peasants marketable ownership rights, and developing a legal system to protect them, would bring huge economic benefits. If peasants could mortgage their land, they could raise money to boost its productivity. Ownership would give them an incentive to do so. And if peasants could sell their land, they could acquire sufficient capital to start life anew in urban areas. This would boost urban consumption and encourage the migration of unproductive rural labour into the cities. For China to sustain its impressive growth rate and reduce inequalities, getting the many tens of millions of underemployed peasants off the land and into wealth-creating jobs is essential. The exodus would help those left behind to expand their land holdings and use them more efficiently.

No government, least of all the control freaks who run China, would embark on such a momentous exercise lightly. Communist Party ideologues are all too aware that a failure to handle rural issues properly can be destabilising. They worry that allowing peasants to sell their land could restore a rural landowning class, and that peasants would sell up in huge numbers and descend upon ill-prepared cities, throwing up shanty towns and pushing up crime.

Some officials also see collective ownership of rural land as one of the few remaining badges of China's professed “socialism”, and fear the explosion of divisive political debate if this bit of constitutional dogma is changed. In China's case, however, it is the absence of reform that is proving destabilising, as peasants protest violently against land seizures by local governments keen to exploit the land themselves. Though materially better off than they were in 1949, many peasants say that local bureaucrats have in effect become the landlords, sometimes using mafia-type gangs to push them off their fields.

A few opponents of land reform in the countryside say they are acting in the rural population's own interests. They point to the lack of social-security provisions for peasants. Though peasants have limited control over the land they farm, in most cases it can at least help to feed them.

The weakness of this argument is that forced appropriations by local governments have already deprived as many as 40m peasants of some or all of their land since the early 1990s, with little or no compensation. Besides, the best way to secure the welfare of the peasants is not to keep them trapped on underworked land but to spend more directly on services for the poor. With strong revenue growth, a low budget deficit and a booming economy, China can afford this. Compensating peasants for appropriated land on the basis of market values, not just minimal agricultural ones, would help too. And introducing a value-based property tax would persuade local governments to worry less about losing the one-off revenues they now enjoy from the sale of land rights.

It would be disingenuous to deny that land reform will loosen party control in the long run. A decade ago almost all urban housing was owned by the state. In one of the most dramatically successful economic reforms of the past quarter century in China, most is now privately owned. This has fostered the growth of a middle class that wants guarantees that its new assets are safe from the party's whims. Property owners are electing their own landlord committees—independent of the party—to protect their rights. A new breed of lawyers, not party stooges as most once were, is emerging to defend those whose properties are threatened by the state. Property owners want a clean environment around their homes. Green activism, which hardly existed in China a decade ago, is spurring the development of a civil society.

Even so, China's Communist Party has shown that it will take big risks if economic development demands them. Hence the widespread closure and privatisation of state-owned enterprises in the past decade, with the loss of millions of jobs. The leadership knows that China's history has been one of recurring bloody upheavals by landless peasants; it is caught between wanting to retain control and wanting to avoid another upheaval. This is the moment to complete the unfinished business of rural reform.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

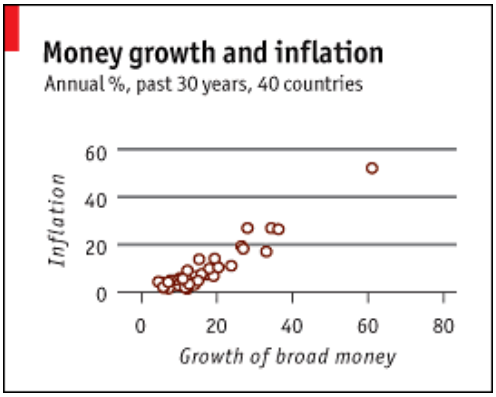
About sponsorship

Central banks

Running on M3

Mar 23rd 2006
From The Economist print edition

Ignore money at your peril



ONCE, a central banker who did not believe in monetarism would have been viewed as equivalent to a priest who admits to being an atheist. A quarter of a century ago, control of money was seen as both necessary and sufficient to curb inflation—so most central banks set monetary targets. Monetarism has since become unfashionable. Financial deregulation and innovation made the money supply harder to interpret, let alone control. As the link between money and prices seemingly broke down, central banks scrapped money targets and instead focused on inflation directly. Or as Gerald Bouey, a former governor of the Bank of Canada, once said, “We didn't abandon the monetary aggregates, they abandoned us.”

Today, America's Federal Reserve barely glances at money. Indeed, from this week it will stop publishing M3, its broadest measure of money. The Fed claims that M3 does not convey any extra information about the economy that is not already embodied in the narrower M2 measure, so it is not worth the cost of collecting it. It is true that the two Ms move in step for much of the time, but there have been big divergences. During the late 1990s equity bubble, for example, M3 grew faster; over the past year, M3 has grown nearly twice as fast as M2. So it looks odd to claim that M3 does not tell us anything different. The Fed is really saying that it doesn't believe money matters.

It is ironic that the Fed is dropping M3 only days after a conference was held to honour Otmar Issing, chief economist of the European Central Bank (ECB) and the architect of its highly money-oriented policy (see article). At that meeting many economists and former central bankers from around the world expressed unease about the recent rapid pace of growth in global money and credit. As Milton Friedman famously said, “Inflation is always and everywhere a monetary phenomenon.” Monetary aggregates are a fickle guide to the economy over the next year, but over longer periods the link between money and prices still holds. Many big mistakes in economic history were made when policymakers ignored monetary signals: the Great Depression in the 1930s, the great inflation of the 1970s, and the financial bubbles in Japan in the late 1980s and East Asia in the late 1990s.

Those experiences surely suggest that central banks should keep a close eye on the growth in money alongside their immediate inflation goals—which is exactly what the ECB has done, with its much (and unfairly) criticised “two-pillar” strategy. The first pillar looks at how economic activity might influence inflation over the next year or two; the second focuses on the growth in money as a cross-check on medium- to long-run developments. The Bank of Japan's new monetary-policy framework adopted earlier this month has borrowed several elements of this approach. The Bank plans to focus on price stability and growth one to two years into the future, but also to carry out a broader assessment of medium- and longer-term risks, such as asset prices and credit growth. So, in scrapping M3, the Fed is looking like the odd man out.

Research by the Bank for International Settlements has confirmed that monetary aggregates do still contain useful information. In particular, rapid growth in money and credit as well as asset prices usually signals the build-up of economic and financial imbalances, which often cause financial stress later on. Central banks cannot use the money-supply numbers as a way to set monetary policy on auto pilot: but they would be foolish to ignore the hazard warning lights.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

European economies

Europe inside out

Mar 23rd 2006
From The Economist print edition

The reason why Europe finds reform so hard is that insiders are too protected

Reuters

IF YOU want to know why Europe's governments have been so hopelessly slow at reforming their economies, waste no time assessing the platitudes about the “Lisbon agenda” at this week's European Union summit. Instead, ponder a few recent events around the continent.

The streets of France have been filled with huge protests against a new labour contract: the biggest so far is due on March 28th (see article). In Germany public-sector workers have staged a series of protest marches over pay. Even Britain, which has reformed its economy more than most, will next week see a big demonstration against public-sector pension changes. And in Italy's rancorous election campaign, both government and opposition have been too fearful of voters to talk about the radical reforms that the country needs.

What links all these things? In part, the perception that change is painful and that potential losers always shout louder than potential winners. This is, indeed, the classic explanation for the popular appeal of trade protection. In recent months, it has manifested itself in the vociferousness of Europeans who have been fighting not just against new labour laws but also against energy liberalisation, freer trade in services, the opening of markets to migrant labourers from central Europe and takeovers of favoured national champions.

But something else obstructs would-be reformers in Europe. This is an acute case of a particular economic complaint: the excessive protection of insiders at the expense of outsiders. In Europe, insiders have permanent jobs with nigh-impregnable security, high wages, guaranteed pensions and a still generous welfare state that they know how to exploit. They are more often male, middle-aged and white than female, young or from ethnic minorities. Many work in the public sector. Others, such as shopkeepers, taxi drivers, lawyers or pharmacists, are insulated from competition by a web of regulations. Outsiders have none of these benefits.

Worse, the few reforms that have been made have often left insiders largely untouched. France's new job contract is only for the young—and, if the government offers more concessions, it may not even help them much—while insiders will keep all their old job security. Too many labour-law changes have created two-tier markets, with an inner tier remaining protected but an outer one on temporary or short-term contracts. Pension reforms have often stopped when they reach sensitive bits of the public sector. And some governments have tried only to change welfare systems and labour laws, which is necessary if unemployment is to be reduced but can also create insecurity and drive down consumer spending. They have neglected the vital accompanying task of injecting more competition into protected industries and services, which would both create jobs and cut costs.

Besides the sheer inequity of perpetuating an insider/outsider divide through unreformed labour markets and a lack of competition, there are two big practical objections. The first is that it keeps economies so inflexible. One outcome is the high unemployment of France and Germany. But another case is Italy, where plenty of temporary jobs have been created, but protected insiders have continued to win big wage increases. Italy has reduced unemployment, but rising unit labour costs are squeezing firms out of markets, a big cause both of slow economic growth and of demands for trade barriers.

You can't buck the market for ever

That leads to the second, even bigger objection to the cosseting of insiders: in the end, it will not work. If it were possible always to insulate insiders, there might be a better argument for doing it. In Germany, for example, businesses have temporarily cut costs and regained competitiveness without ending the insider/outsider split. But they have done it without creating more jobs at home, so unemployment remains high. Thus, even in Germany the pressure of global competition is such that insiders cannot be protected from it for ever. The only real options are to accept change now, or to defer it until economies get into such straits that change is forced. The risk that much of Europe is taking by delaying reforms and appeasing protesters is that it ends up taking this second-best choice.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Britain's budget

The chancellor who would be prime minister

Mar 23rd 2006
From The Economist print edition

A do-nothing budget is a missed opportunity to nudge the economy back on track

Reuters

NINE years is a long stint in any job. For a country's finance minister, it is a political lifetime. Gordon Brown's tenure as chancellor of the exchequer since May 1997 has become an historical record in itself. The pages have to be turned back to Victorian times to find a predecessor—William Gladstone—who held this venerable position for longer.

That is a record Mr Brown does not want to beat. He has his sights set on succeeding Tony Blair as prime minister. His ambition will almost certainly be realised within at most two years; the main question is whether he might take over sooner. But as a keen student of history, Mr Brown will be aware of worrying precedents. The last chancellor to move from Number 11 to Number 10 Downing Street was John Major, who had a miserable time there. More recently, Paul Martin, another long-serving finance minister, held Canada's top job for a shorter but just as miserable stretch.

The main threat to Gordon Brown

There is a particular danger for a chancellor-turned-prime minister: inheritance of the economy and public finances over which he has himself presided. Mr Major's administration was wrecked on “Black Wednesday” in 1992 when the pound was turfed out of the European exchange-rate mechanism that he himself had decided to join as chancellor in 1990.

To his credit, Mr Brown has avoided another disastrous entanglement with European monetary policy by keeping Britain out of the euro. Furthermore, the economy has in many respects been a success on his watch (see article). His early decision to hand over control of interest rates to the Bank of England has proved a masterstroke. Both growth and inflation have been uncannily stable over the past decade.

Yet there are worrying signs of deterioration. Britain's exceptional economic performance over the past ten years owed much to an unsustainable boom in consumption and the housing market. That ended last year, in turn cutting GDP growth to 1.8%, its lowest since 1992. Despite Mr Brown's optimistic forecasts for faster than usual growth in 2007 and 2008, the outlook is duller, as the economy toils under the growing burden of taxes and regulation that he has imposed.

The fiscal damage has been done by the need to pay for Labour's spending splurge, a policy for which the chancellor must take full responsibility. After initial restraint, Mr Brown opened the spigots full blast. Government spending has risen in real terms for six years at an average annual rate of 4.9%, well ahead of GDP growth. Paying

for this has caused a massive swing in the public finances from surplus to deficit. Between 2000 and 2005, only two rich countries, America and Luxembourg, have seen their structural budget balances go to pot faster than Britain's. Inevitably, the taxpayer is picking up the bill: the tax burden is due to rise in the fiscal year that starts next month to its highest share of GDP in two decades, 38%.

If Labour had been a wise as well as a big spender, then the spigot-opening might be more forgivable. But much of the money has gone into higher salaries, turning Britain's doctors into the best paid outside America. The chancellor's big idea for trying to get value for money in the public services—a Soviet-style regime of targets—was a bad mistake. Either targets are too easy to meet or they are hit by compromising other important aspects of performance that are not expressly targeted. Yet, too often, Mr Brown has appeared to resist the much more promising approach, backed by Mr Blair, of reforms to foster choice and competition in the public services.

The chancellor has recognised these weaknesses, if the course he set for the public finances in this week's budget is any gauge (see article). Spending increases are already cooling. From spring 2008, the climate will turn cold, with expenditure planned to grow at an annual rate of only 1.9% in the three years to 2010-11. Mr Brown is also making much of his efforts to squeeze greater efficiency out of public services.

But this do-nothing budget was a missed opportunity to start putting things right sooner. Mr Brown is taking a big risk in postponing the spending clampdown and leaving himself with little margin for error. If, for example, the economy runs into trouble later this decade, then his plans for apparently modest public spending growth may yet prove unaffordable, just when they might be most needed. The chancellor was fortunate to inherit a strong economy whose public finances were improving sharply. If Mr Brown's inheritance as prime minister is a weakening economy and a chronic budget deficit, he will have only one person to blame: himself.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com OPINION
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Israel's election

The remarkable survival of Kadima

Mar 23rd 2006
From The Economist print edition

Israel prepares to take a step forwards, the Palestinians a step back

Reuters

UNLESS the polls are wildly wrong, and they could be given the number who are undecided, something remarkable is about to take place in Israel. The Kadima party formed by Ariel Sharon just before he was felled by a stroke in January seems poised to win next week's election. By the standards of stalemated Palestine, this is good news. Mr Sharon created Kadima to break free from the national-religious settler movement, which had put a stranglehold on the Likud party. The settlers were determined to punish him for clearing Israel's settlements out of Gaza and to prevent another withdrawal from the West Bank. If Kadima wins, they will have failed. Ehud Olmert, Mr Sharon's successor, has made it plain that he will evacuate many Israeli settlements on the West Bank, in order to give Israel permanent borders and make room for a two-state solution in Palestine (see article).

Two things make all this remarkable. Only a few months ago Kadima seemed wholly dependent on the popularity of Mr Sharon. The fact that it has prospered without him suggests that Israelis are no longer just putting their faith in a strongman but have accepted Kadima's argument that the old dream of Greater Israel is dead and that Israel must pull back towards its pre-1967 borders. No less remarkable is that Kadima has won this argument even after the Palestinians voted in January to elect Hamas, the extremist Islamist party whose trademark is the suicide bomb and whose aim, as explained out of at least one side of its mouth, is that Israel should be erased.

So the Palestinians take a step back from peace, and the Israelis take a step forward. What explains this paradox? The simple answer is that Israelis have stopped caring whether they are walking in step with the Palestinians. The two sides tried that for much of the 1990s and kept falling over. After the second *intifada*, the Israelis and the Americans decided that Yasser Arafat could no longer be a partner. Mahmoud Abbas, the Palestinians' new president, seemed—and was kept by Israel—too weak to fill the gap. Mr Sharon pulled out of Gaza without consulting the Palestinians. With Hamas in charge Mr Olmert will follow his example on the West Bank. Since the Palestinians are a shower, goes the common Israeli perception, we had better do whatever has to be done on our own.

Unilateral moves can have merits. That is to say, a movement in the right direction must be better than utter immobility. And the direction Mr Olmert promises—driving another nail into the settler movement's coffin by more withdrawals—is the right one. Nonetheless, Israelis had better understand that even if going it alone eases some of the burden of occupation for both sides, it is no substitute for a negotiated peace. The border Mr Olmert establishes by fiat along Israel's security barrier will remain unacceptable to the Palestinian side no matter how many Jewish settlers—and it could be as many as 60,000—on the far side are uprooted in the process. Besides, Israel intends to keep its army in the evacuated areas and along the Jordan valley. So this will not feel to the Palestinians like any end to the hated occupation.

Is immobility really the only alternative to Mr Olmert's unilateralism? It probably is, if the incoming Hamas government is to be taken at its word, and barring a big international peace initiative. Some Hamas leaders now say that if Israel promised to leave every inch of territory it occupied in 1967, Hamas might think again about its formal goal of rubbing out the Jewish state. That implies a degree at least of pragmatism in Hamas's thinking,

which Israel and others should try to encourage—but it hardly qualifies as grown-up diplomacy of the sort that could lead to a negotiated peace. For the present, unilateral steps by Israel and the maintenance of calm by Hamas may be the best Israelis and Palestinians can hope for.

Just leave some room, Mr Olmert

There is, however, unilateralism and unilateralism. If Mr Olmert's ultimate objective is peace, his unilateral steps must be designed to make negotiation feasible, not to block it altogether or harden the hearts of Palestinians still more. That requires moderating Israel's territorial appetite. As presently envisaged, Mr Olmert's barrier bites big lumps off the West Bank, locks the Palestinians out of Jerusalem and inflicts severe hardship on the people who live in the barrier's path. If the years of killing prove anything, it is that neither side can impose its terms on the other. Hard as it will be now that it is Hamas that is its counterpart, Israel needs to show that when negotiation comes, there will still be enough room left for an independent Palestinian state worthy of the name.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

On India, the National Health Service, William Wilberforce, corruption, Nelson Mandela, organs, underwear

Mar 23rd 2006
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Harnessing nuclear power

SIR – India's fast-breeder nuclear reactor programme exists because it has no uranium and relies on large reserves of thorium ("Dr Strangedeal", March 11th). The reactors' ability to produce material for bombs is, contrary to your assumptions, only incidental. Moreover, the reluctance of Indian scientists to subject these reactors to safeguards is born out of decades of discrimination against India, not only in the nuclear field but in other areas as well. When a scrupulous democracy like India seeks to use nuclear technology to rid itself of poverty, and when a world leader like George Bush sees a way to do this, are you not ashamed to then advise the United States Congress to block the deal?

A. Raja Rao
Bangalore, India

SIR – Mr Bush stated that part of his rationale for striking a nuclear agreement with India was that the development of its civilian nuclear capacity would ease its demand for energy, thereby alleviating the pressure on world oil markets. However, Mr Bush's suggestion belies the fact that India uses virtually no oil in generating power. Paradoxically, Iran's assertion, strongly repudiated by the Bush administration, that its nuclear-based electricity will free hydrocarbon supplies for export, has an inherent logic (notwithstanding the suspicion aroused by Iran's nuclear strategy). Maybe the State Department's Indian strategists ought to have lunch with its Iranian strategists?

Joel Darmstadter
Bethesda, Maryland

SIR – Methinks you protest too much when criticising Mr Bush's latest initiative. So what if it violates international accords and several decades of bipartisan American policy on nuclear proliferation? And so what if the deal allows "India in future to produce scores of weapons a year, not just a handful", which will accelerate the nuclear arms race in Asia and elsewhere? The clincher, the one truly ingenious aspect of this transaction, and one which Mr Bush expressed so eloquently during his press conference with India's prime minister, is this: "...the United States is looking forward to eating Indian mangoes. Part of liberalising trade is to open up markets." What more can people ask for?

Major Dorian de Wind
(US Air Force, Retired)
Austin, Texas

Health measures

SIR – The results reported by the Office of National Statistics on measuring productivity in the National Health Service do indeed demonstrate that a wide variety of estimates are possible depending on the inputs and outputs used and the assumptions made about them ("Take your pick", March 4th). The reality is that, at present, there is no accepted measure of the value of total NHS output and comprehensive data to calculate one does not exist. That is why the work of the ONS, and of others on which it is based, falls into the "ongoing research" category. We have neither accepted nor rejected the Department of Health's estimates on output and we hope that our work will stimulate work in this field, which will include testing the Atkinson report's principle of increasing value in a growing economy. To assist in this, ONS will facilitate a wide-ranging public consultation and debate.

Karen Dunnell
National statistician
Office of National Statistics
London

Historical reputations

SIR – I read Lexington's characterisation of Senator Sam Brownback as a "Wilberforce Republican" with astonishment (March 11th). I have nothing derogatory to say about the senator, but I do take serious exception to comparing the position that William Wilberforce took throughout his life with today's narrow stance of the Christian right in political dialogue. Wilberforce stood far above partisan politics and fought a personal crusade to abolish slavery at the sacrifice of a ministerial, even possibly a prime ministerial, career; his saintly reputation is richly deserved. The name of William Wilberforce is maligned today by any who adopt it meretriciously for their own petty purposes, to the indignation of this, his great-great-great-grandson.

George Wrangham
Wayne, Pennsylvania

Hard graft

SIR – Paul Wolfowitz could introduce consistency in his anti-corruption campaign at the World Bank if he implemented a corruption rating system with two factors based along the lines of the Basel 2 accord ("Just saying no", March 4th) The first factor is a corruption rating for sovereign borrowers, in which the rating would be an estimate of the borrower's portion of the graft. The second is a rating for facilities (individual loans, etc), which would be an estimate of the portion of the loan likely to go to graft. The bank could reject loans to countries that have too high (or low, depending on how the rating system is set up) a corruption rating, and individual loans that have too high (or low) a facility rating.

Peter Eggenberger
Oakland, California

Taking a stand

SIR – I must respond to the confusion surrounding Nelson Mandela's stance on non-violence, which was started by your review of Taylor Branch's biography of Martin Luther King ("Freedom man", February 18th). Reverend Scott Couper compounded this confusion in his letter to you, which stems from labelling Mr Mandela as a "follower" of King (Letters, March 11th). In fact, the opposite was true. Mr Mandela led the African National Congress's non-violent defiance campaign of 1952, and his arrest for breaking the Pass Laws (where blacks had to carry identification at all times) was an inspiration to King. It is true that Mr Mandela saw non-violence as a tactic rather than a principle, but we should remember that the ANC turned to armed revolution only after the government banned peaceful protests and arrested the movement's leaders.

Alan Hirsch
Pretoria

Vital organs

SIR – People should have the right to harvest and sell their organs ("Organs to order", March 11th). If the law recognises our right to give away an organ, it should also recognise our right to sell an organ (as long as there is no coercion involved). Those who could afford to buy organs would benefit at no one's expense but their own. Those unable to pay would still be able to rely on charity, as they do today. If the government upheld these rights, many of the thousands of people now waiting for organs would be spared hideous suffering and an early death. How many? There is only one way to find out: set these people free.

David Holcberg
Ayn Rand Institute
Irvine, California

Lingerie flaw

SIR – Your article on Turkey's garment trade was interesting ("Beyond the veil", March 4th). But what led you to suggest that Muslims don't enjoy erotic underwear too?

Dolores Rodriguez
Mexico City

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Israel's new politics

Shutting itself in, hoping for the best

Mar 23rd 2006 | JERUSALEM, OFRA AND UMM AL-FAHM
From The Economist print edition

Reuters

Israel looks set to vote on March 28th for unilateral withdrawal. But the determined unity of the mainstream belies deep fractures in society

Get article background

THIS is not just any election. It is, in effect, a referendum on the most significant territorial withdrawal in Israel's history; on the future shape of its borders; and on how the country should respond to the rise to power in the Palestinian Authority (PA) of a radical Islamist party that, at least on paper, still calls for its destruction. It is an election that comes on the heels of six months of upheavals—Israel's "disengagement" from Gaza, Ariel Sharon's bolt from the Likud to form his Kadima party, his abrupt removal from political life by a massive stroke, and Hamas's election victory—that have made fools of the wisest soothsayers. Yet everyone agrees on one thing: it is one of the most boring elections they can remember.

The campaigning is simplistic and predictable. The polls are predictable and stable. The scandals, more fruitily scandalous than ever, have sunk in the public consciousness with barely a ripple. The only real uncertainty is how many people will rouse themselves from their electoral stupor and stagger out to vote.

The explanation for this paradoxical apathy is the same as for the calm after an earthquake. The internal pressures that led to the upheavals have done their work. Both the Israeli and Palestinian political systems have adjusted. All that remains is for Israel's voters to sign off on the result.

What the past half-year has done is to give form to an Israeli mainstream that had been inchoate for over five years. During the Oslo peace process of the 1990s, the mainstream could be divided into those who believed in giving up occupied land for peace (Labour) and those who didn't believe in giving it up at all (the Likud).

Then, in 2000, the Camp David peace talks between Ehud Barak and Yasser Arafat collapsed. The Israeli belief that Arafat had rejected Mr Barak's "generous offer" out of hand, though the reality was far more complex, made the violent outburst of the second *intifada* that autumn so shocking that even left-wing Israelis started losing faith in peace talks. "It generated an almost axiomatic belief that in the foreseeable future Israel will have to live as if the Arabs are not around," says Ephraim Yaar, a co-author of Tel Aviv University's monthly Peace Index poll, which has measured Israelis' attitudes for the past decade.

It was Amram Mitzna, the Labour candidate in the 2001 election, who first seriously proposed giving up land without peace talks. Mr Sharon (who had ignited the powderkeg of the *intifada* by entering the Haram al-Sharif, Jerusalem's holiest Muslim site) roundly defeated him by promising to do no such thing. Yet less than three years later, with hundreds of Israeli and thousands of Palestinian lives lost, he announced the Gaza withdrawal. Despite dire predictions and loud protests by the settlers and their supporters, it passed off with virtually no injuries.

This showed that the settlers could be overcome. Gaza's subsequent deterioration, as Palestinian clans, armed gangs and political factions slugged it out, convinced Israelis that the PA under Arafat's successor, Mahmoud Abbas, would never be able to impose the order required to uphold its end of a peace deal. Mr Sharon

had mapped out a third way between peace and war: unilateral withdrawal.

It is true that he himself always said that there would not be another retreat after Gaza. Many wonder how he would have reacted to Hamas's victory. But by then Mr Sharon was in a coma and his fledgling party had an untested leader and no platform—and Israelis had bought into what they believed was Mr Sharon's vision. Kadima had been slipping in the polls, but jumped earlier this month when Mr Sharon's heir apparent, Ehud Olmert (whose face is shown on the billboard above) announced a plan of unilateral withdrawal from large parts of the West Bank, loosely outlining the Israeli borders he foresees. The "centre" may have begun as a group of people united only in their trust in Mr Sharon. Now it is real.

Yet even as the Israeli mainstream has coalesced, several large fringe groups are becoming more detached. The simultaneous merging and fragmentation of Israeli society are visible in the way people say they plan to vote.

Introverts anonymous

Mr Olmert now calls it not *hitnatkut*, "disengagement", but *hitkansut*, or going-into-oneself, often rendered as "convergence". A better word, if it existed in English, would be "introvergence". It is a fitting description. Israel plans to tuck itself in behind the barrier it began building four years ago in the West Bank, withdraw from the land on the other side, pull the settlers living there back over, and hunker down.

As well it might. The plan, though still vague, involves keeping three large settlement blocks that jut out into the West Bank, hindering Palestinian movement. The current gap between Maale Adumim, the largest settlement, and Jerusalem will be filled in with houses, slicing the Palestinian area into two. Almost all of Jerusalem, which is a core Palestinian as well as Israeli city, will be inaccessible to Palestinians. Israel will keep control of the border with Jordan and possibly also the sparsely populated Jordan Valley, as a security buffer. Otniel Shneller, a Kadima candidate who used to head the Yesha Council, the association of settlement mayors, says Israel could also keep its settlements in and near Hebron, arranging shared access to the tombs that are sacred to both Jews and Muslims.

A Palestinian state under such constraints would not prosper. So long as Israel controls its borders, it would not even count as sovereign. It would be much like Gaza since the disengagement. Citing intelligence reports of planned terrorist attacks, Israel has kept Gaza's main border-crossing for goods closed more often than open since the start of the year, causing serious food shortages and leaving Gazan fruit and vegetable exports worth millions of dollars to rot. Such friction between security and economics would keep the West Bank poor and angry, encouraging attacks across the border.

The centre shows the way

Zionist parties	Possible Knesset seats*	Description	Hawkishness	Social-welfare rating	Religious rating	Preferred plan for the occupied territories
National Union-National Religious	8	Pro-settler, religious, hard-right	★★★★★	★★★	★★★★	Keep for ever
Yisrael Beiteinu	10	Russian-speaking, hard-right	★★★★★	★★★★★	★★	Keep main settlements but hand over Palestinian towns in Israel
Shas	10	Sephardi, religious, hard-right	★★★★	★★★★★	★★★★	Keep, at least for now
Likud	16	Traditional centre-right	★★★★	★	★★	Keep for now
Kadima	37	New centre	★★★	★	★★	Withdraw unilaterally, keeping main settlements
Labour	20	Traditional centre-left	★★	★★★	★★	Withdraw unilaterally or by negotiation, keeping main settlements
Meretz-Yachad	5	Secular, doveish left	★	★★★	★	Withdraw by negotiation
Other parties						
Torah and Sabbath Judaism	6	Ultra-religious, Ashkenazi, non-Zionist	Flexible	★★★★★	★★★★★	None
Hadash	3	Secular, Jewish/Palestinian leftist	★	★★★★★	★	Withdraw by negotiation
Balad	2	Secular Palestinian nationalists	★	★★★★★	★	Withdraw by negotiation
United Arab List/ Arab Renewal	3	Islamists and secular Palestinian nationalists	★	★★★★★	★★★★	Withdraw by negotiation

Sources: *The Economist*; *Haaretz*/Dialog poll *Latest polls

But if the polls are to be believed, Israelis see no other choice. Kadima will get 35-40 seats of the 120 in the parliament (see table). Labour's Amir Peretz, a former union boss, was full of talk of peace when he was elected party leader last autumn, but Labour has since come across increasingly as a hopeful coalition sidekick to Kadima, campaigning mainly on socio-economic rather than security issues. In effect, it has joined the centre. The “left” that still pushes actively for peace talks is almost non-existent. The anti-withdrawal right in its various forms makes up most of the rest. But on current polls, it cannot scrape together a majority.

Which is why this election is boring. It may also be why a string of political scandals—an eyebrow-raising property deal by Mr Olmert, the conviction of Mr Sharon's son Omri for illegal campaign fund-raising, and a string of corruption cases—has made no impact on the polls. Mr Olmert's stated goal of completing “introvergence” within four years looks wildly unrealistic when it took nearly two to make a hasty job of abandoning Gaza, but even that has raised hardly a mutter of public debate. The mainstream seems resigned to whatever may be about to happen.

Or almost. There is just one anomaly: undecided voters are still some 20% of the total. Everyone tells anecdotes about lying to pollsters. It may be because, according to the Peace Index surveys, over a third of Israelis still want to leave the door open for peace talks with Hamas, though no mainstream party is seriously offering to hold such talks. That could mean surprises on election day—or a low turnout.

But if the mainstream has sunk into apathy, other groups are girding up for post-election battles. With security issues wrapped up by Kadima, the main campaign issue for most of the other parties has been poverty. When Binyamin Netanyahu, the Likud leader, was Mr Sharon's finance minister, his reforms to clear up vestiges of statism in Israel's economy included many welfare cuts. That has sparked a backlash.

Labour hopes this will help it win a strong showing as the coalition government's social conscience. But the bigger beneficiaries seem to be smaller parties representing traditionally poor Israelis—such as Shas, the party of Orthodox Sephardi Jews (those of Middle Eastern descent), and Yisrael Beiteinu (“Israel is Our Home”), a party for former Soviet immigrants. Ultra-Orthodox Ashkenazi (European) Jews will also have a heavier hitter in the form of Torah and Sabbath Judaism, a union of two of their parties which have often played pivotal roles in coalitions.

But Shas and Yisrael Beiteinu are also hawkish in the extreme. Avigdor Lieberman, the latter's leader, advocates transferring Arab-Israeli towns near the West Bank, such as Umm al-Fahm, to the PA so as to increase Israel's Jewish majority. He would strip their residents of Israeli citizenship, and apply a “loyalty test” to those Arab-Israelis who remain. Two other small parties hold similar views. Such ideas, once the preserve of the Kach party that was banned from running in 1988 for inciting racism, are now “at the heart of the elections,” says Issam Makhoul, an MP for Hadash, one of the three small parties that represent Arab-Israelis.

That is just one of many trends that worry the Palestinian citizens of Israel, who make up nearly a fifth of the population. Always equal citizens on paper more than in practice, since the *intifada* they have become more and more marginalised. A police shooting of 13 people in the Christian-Arab city of Nazareth, just after the *intifada* began, left deep scars. The failure to bring anyone to book, and a series of similar incidents since, has left simmering anger. On top of this, there is the West Bank barrier that separates many people from relatives and friends; chronic inequality in government funding for Jewish and Arab towns; widespread discrimination in hiring for jobs in the government and utility companies; and government plans to develop the northern Galilee and southern Negev regions, which have large Palestinian and Bedouin populations, by enticing more Jews to move there.

Unheard voices

But the community is divided about how to vote. Some say that since governing coalitions never include Arab parties' MPs

and usually ignore the bills they propose, the vote should go to mainstream parties instead, who might then start to listen to their Arab voters. The question is particularly acute because the threshold for getting into parliament has gone up to 2% of the national vote. The three parties are so ideologically different that they cannot unite, but if Arab turnout is low, one or another might not make the 2%.

The Arab-Israelis' basic concern is whether Israel will always be a country that overtly privileges Jewishness. Another chunk of Israeli society, nearly the same size, has the same concern—for the opposite reason. These are the religious Zionists: observant but not ultra-Orthodox Jews who believe (for a mixture of historical and religious reasons) in holding on to the occupied territories. They were the pioneers of the settlements, but these days they feel as besieged and unwanted by the Israeli mainstream as the Arabs do.

Though the evacuated Gaza settlers got a lot of compensation money, a combination of hasty planning and their own refusal to take part in it meant that their communities have been thrown to the four winds. Last month, according to official figures, some 30% of the 8,000-odd Gaza evacuees were still living in hotels. Others will be in temporary housing for years. Their sympathisers were outraged by a report by the state comptroller earlier this month, which threw the book at the authorities for failing to plan and carry out the relocations properly.

Those furious teenagers

At the beginning of February, the demolition of nine illegally built houses at Amona, an outpost of the Ofra settlement in the West Bank, saw worse violence between the police and young protesters than during the whole of the Gaza evacuation. Settlers say that the police used force indiscriminately against peaceful protesters, a claim now under parliamentary investigation. But the teenagers may have been emboldened by their resistance to last summer's evacuations—and disenchanted with the Yesha Council, which they see as appeasing the authorities.

Kadima has its bridge-builders to the settlers. Mr Shneller, the former Yesha Council head, and Rabbi Yoel Bin-Nun, a spiritual leading light of early settlers, have joined its ranks. Mr Shneller says the trouble at Amona was the work of a tiny minority within the complicated settler taxonomy: an extremist fringe (those seeking trouble) of a hardline group (those living in unauthorised outposts down the middle of the West Bank) of the ideological settler minority (fewer than 70,000 people) who live in those parts of the West Bank that Kadima wants to give up. Most settlers, he thinks, can be persuaded to swim with the tide of “introvergence” if given proper care and lots of compensation.

But the wider religious-Zionist public is still in shock. “Even moderates [among the religious Zionists] have been scared by the brutality at Amona,” says Yisrael Harel, a former Yesha Council leader, “and they are taking it as an attack on them.” The comments being voiced sound, in fact, much like the ones one hears from Arab-Israelis. “They treat us as one big block. We all look the same to them,” says Yifat Ehrlich, who owned one of the demolished houses at Amona but had moved out months before. She notes that the talk used to be about whether Israel should negotiate with the Palestinians, but now is about whether to negotiate with the settlers.

Religious Zionism was already undergoing fragmentation, exacerbated by its internal debates over how to react to the Gaza pull-out. Ironically, had the government accepted a rather hare-brained proposal by the Yesha Council to delay the demolitions and move the houses somewhere else, says Mrs Ehrlich, “we would probably have eaten each other up. But the conflict united the community.”

Like Arab-Israelis, the settlers and their sympathisers are concerned about many other things that the Israeli mainstream wants to do to their role within Israel. They warily eye proposals to cut budgets for religious education and benefits for large families, or reduce the influence of the rabbis in national affairs (for instance, by creating the institution of civil marriage).

And like Arab-Israelis, they are divided about how to vote. There is talk of abstention. There is also talk of going with the hard-right National Union and National Religious Party, which like the ultra-Orthodox parties have made themselves more attractive by merging into a single force.

Not a happy family

As it enters its era of “introvergence”, Israel looks like a parent entering middle age: more solid of body and firm of mind, but surrounded by a brood of bickering and rebellious children. Its relations with the neighbour seem beyond repair, but the house is sturdy. The path looks clear.

But less clear is how far down the path it can go. The immediate costs of what it wants to do will be enormous. The settlers' resistance may be too fierce. Even if quashed, it could do more damage to the unity of Israeli society than the Palestinian resistance to occupation ever did. And Israel's desire to shut out the Palestinians will rebound on those Palestinians who are also Israelis, causing further tensions.

Nor will it begin to solve the conflict with non-Israeli Palestinians, whose plight after Israel's partial withdrawal from the West Bank will continue to stoke hostility in the rest of the region. But there is not much the Palestinians can do about it at this time. Though there are already dire warnings of a third *intifada* in the making, more such attacks will only strengthen Israel's resolve to shut itself in, close its eyes, and hope for the best.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Foreign policy

How to go global

Mar 23rd 2006
From The Economist print edition

A quiet revolution is occurring in what America expects of its friends

GEORGE BUSH may be consumed at home defending his policies in Iraq against the 60% of Americans who now disagree with his handling of the war. But Europeans hoping that the hard lessons being learned daily in Baghdad and Ramadi (see article) would force the administration to adopt a more collegial foreign policy are at last starting to see results. Why, then, are some of them fretting that the transatlantic alliance is about to drift farther apart?

Recent evidence would suggest there is more common diplomatic ground, not less. Since Mr Bush's visit to Brussels just over a year ago, in a bid both to reinvigorate NATO and to strengthen America's ties with the European Union, diplomats from both sides of the Atlantic have co-operated intensively over how to handle Iran's nuclear ambitions, Syria's meddling in Lebanon and conflicts in Africa. An earlier tiff over the Europeans' plans to lift their arms embargo on China kicked off a “strategic dialogue” on Asian security (meaning how to handle a rising China). There are more regular talks these days, too, about where Vladimir Putin's troubling Russia is heading.

There is not always agreement. But at least the most difficult issues under discussion are often the ones the two sides broadly agree on. This week, toing and froing across the Atlantic over tactics contributed to the delay at the UN Security Council in getting Russia and China to back a first rap over the knuckles for Iran.

But it is not just better conflict-management within the alliance that Mr Bush is after. There is also a quiet revolution under way both in what America expects of its own diplomats and soldiers around the world and what it will be asking of its friends.

Administration officials are urging their NATO partners and other close allies such as Australia, Japan and South Korea to think—and if need be act—more globally. Some of the Europeans, at least, are far from ready. For NATO, the crunch is likely to come at its planned summit in Riga in late November.

In the light of Iraq, Mr Bush's rethinking is not chiefly about what America should be doing in the world. It is still “at war” with international terrorism, he explained in last week's updated National Security Strategy. It will still take on the world's proliferators, such as North Korea and Iran. And despite the election victory of Hamas in Palestine, his administration makes no apologies for its support for democratic change in the Middle East and beyond. But what Mr Bush's secretary of state, Condoleezza Rice, has called America's “transformational diplomacy” is about means and partners, as much as ends.

Between the lines of the new security strategy and the Pentagon's earlier Quadrennial Defence Review is a recognition that military force is not going to be the most useful means to achieve what Ms Rice has called “a balance of power that favours freedom”. America fully intends to remain the world's pre-eminent military power.

But the most thoughtful talk now is of more coherent diplomacy, with soldiers and diplomats working more closely both in conflict prevention and post-conflict reconstruction. And this from a team that used to insist, disparagingly, that America didn't “do windows” (or, as others would put it, nation-building).

Above all, allies are back in vogue. That is a welcome change after a period when it seemed that—at the White House and the Pentagon at least, and with Iraq partly excepted—seeking help even from friends was considered a sign of weakness. And it ought to be music to anxious European ears. Like talk of a “war” on terrorism, which always carried uncomfortable overtones to outsiders of a preference for force over diplomacy, America's apparent enthusiasm to act unilaterally had cast a chill over transatlantic relations.

Meanwhile, America is already shifting some military and diplomatic resources away from bases and diplomatic posts in Europe to where the new threats and opportunities are: in the Middle East, Asia (with the rise of a competitive China and a friendlier India) and Latin America. There will be more changes in the years ahead. Though some Europeans, notably Britain, are also taking a hard look at what is still partly a cold-war shape to their diplomatic presence and capabilities, others are anxious that America's diplomatic shifts mean it is losing interest in Europe. But the greater concern is that America will now expect too much of its allies.

What Mr Bush is after is a different, more ambitious sort of alliance altogether. Awkwardly, however, just as America is reviving its interest in Europeans as partners, the Europeans, suffering their own protectionist strains and with their confidence sagging after last year's failure to win an agreed constitution for the European Union, are not best placed—or may be downright unwilling—to respond.

Certainly, America is not turning its back on Europe, insist officials at both the State Department and the Pentagon. Far from it. But the Atlantic alliance should no longer be about defending already secure real-estate in western Europe, argues one senior State Department man. It should be about what America and Europe can do together in the wider world where the new threats come from. Hence the nascent plans for a more global alliance that America hopes will be accepted at NATO's Riga summit later in the year.

The alliance has been tiptoeing in that direction for a while. It is about to take over security duties in Afghanistan; for months the NATO Response Force, trained for mobility, impact and reach, helped bring relief to earthquake victims in Pakistan; and NATO helped lift African Union peacekeepers into Darfur and may be called on to do more if the AU force is strengthened under United Nations auspices.

Learning to work together

But it is one thing for those NATO members with the capability and the will to take on problems far beyond Europe, as and when they can. Getting the alliance to function with that as its organising principle is a different proposition.

For one thing, it will force NATO's continental European members to confront anew their own well-known shortcomings: everything from the shortage of long-range transport aircraft to the meagre tally of truly deployable forces (still only in the tens of thousands out of a pool of well over 1m in uniform) and their lack of inter-operable radios. Another proposal for Riga is to change the way NATO finances its operations, obliging those that don't have much to contribute militarily to chip in more of the costs of those that do. Yet defence budgets in many European countries have been static or falling in recent years. Meanwhile, countries like Australia and Japan are listening with interest as plans are floated to offer them more opportunities to work with NATO, based on common operating standards.

There are two ways for Europeans to look at all this. The traditional one is to fret about where such changes might lead and how much they might cost. There is concern, particularly, that America would rather leave intractable problems, such as instability in the Balkans or Africa's incessant wars, to the Europeans to sort out. Enthusiasts for a more globally-orientated Europe, on the other hand, see this as a moment of opportunity to rebuild a reinvigorated alliance with America, one with a purpose, not just a past. But they also worry about the consequences if European members of NATO fail to rise to the challenge.

For countries such as Britain and France, accustomed to sending their soldiers to far-flung parts, the stretch to a more fully global role is one they know they have to try to make, since the threats to Europe's security these days can come from anywhere. Others, including Germany, feel they are already stretched quite far. Some would rather do little, if anything at all. Meanwhile, France may still object to turning NATO into the place where Europeans and Americans (and others) regularly discuss broad security concerns, although Germany's chancellor, Angela Merkel, has publicly supported the idea.

Similarly, concerns that Asia is beyond Europe's reach, and should be beyond NATO's too, are given the lie by the recent deployment, albeit a modest one, of EU monitors to Aceh in Indonesia. Closer to home, but in a more dangerous place, the EU last year agreed to help monitor the (now mostly closed) Rafah crossing between Gaza and Israel. All these steps are far beyond the security duties most Europeans were even contemplating, let alone doing, even five years ago.

At the State Department, at least, officials are clear that, given the choice, they would prefer to have some of their European allies with them (no one expects all of NATO's 26 members to turn out together any more) in pretty much any tight spot. They are the strongest democracies, with the best capabilities: acting together, they provide a “quorum of democratic legitimacy”, says one.

But with or without the Europeans, America will continue seeking partners where it finds them. Its post-tsunami relief effort early last year around the Indian Ocean was closely and effectively co-ordinated with Australia, Japan and India, and is widely seen as one model of coalitions to come. Both South Korea and Japan have contributed troops, alongside some Europeans, to reconstruction efforts in Iraq, while Japan continues its logistical support for coalition efforts in Afghanistan and beyond. Bringing these two and others closer to NATO's well-rehearsed ways of doing things would make sense.

Building capable coalitions for different purposes is the name of the game. Will NATO in future operate as the crucial hub of such a global and varied network of alliances? The Europeans have until that November summit to decide.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Black Republicans

Are there any?

Mar 23rd 2006 | SARASOTA, FLORIDA
From The Economist print edition

Yes, but they keep quiet about it

AFP

A bold man

ASKED why she switched from being a Democrat to a Republican, Carolyn Mason sounds defensive. “It's a free country,” says the former mayor of Sarasota, Florida. “I don't need to ask anyone's permission.” Was it something to do with the Republican ideals of hard work and personal responsibility? “That's the way I was brought up,” she says, but won't elaborate.

Being black, Ms Mason has been pilloried for joining the party of George Bush. Black Republicans are a tiny minority, and mostly keep their affiliation quiet. “Democrats call us ‘sell-outs’, ‘tokens’, ‘Uncle Toms’ or ‘Aunt Jemimas’,” says Frances Rice, the chairman of the National Black Republican Association. “Yet when you ask black people about their values, they agree with Republicans 100%.”

That is a big exaggeration. But it is clear that the diversity of black opinion is poorly represented in government. All 43 members of the Congressional Black Caucus are Democrats. Because of gerrymandering, most come from majority-black districts. Since Republicans usually don't have a hope in such districts, the contest that matters is the Democratic primary. To win, a candidate must appeal to party stalwarts, who are typically more radical than regular voters. The effect of this on black politics is striking.

For example, black Americans tend to be quite socially conservative, but their representatives are anything but. Only four black congressmen voted to ban partial-birth abortion in 2003, though most blacks abhor the procedure. On practical issues, too, there is a disconnect. Most African-Americans favour school choice, yet not one black member of Congress voted to support a voucher programme to rescue mostly black pupils from failing schools in Washington, DC. Blacks are stiffed by the current pay-as-you-go Social Security system, because they die younger than whites and so collect fewer benefits. Yet blacks in Congress were united in their opposition to Mr Bush's tentative reform plan last year, which now appears doomed.

Republicans see this rift as an opportunity. The party is grooming more than 50 black candidates for national office this year, says Tara Wall of the Republican National Committee. The most prominent include two would-be governors, Lynn Swann in Pennsylvania and Ken Blackwell in Ohio, and two senatorial candidates, Michael Steele in Maryland and Keith Butler in Michigan. Ken Mehlman, the party chairman, implores blacks not to let the Democrats take their votes for granted. “Give us a chance, and we'll give you a choice,” he said last year.

The Republicans don't need to win a majority of black votes. If they won as much as a quarter, that would keep the Democrats out of power indefinitely, reckons Mrs Rice. But even that modest-sounding goal is virtually impossible, at least in the short term. George Bush won more of the black vote in 2004 (11%) than in 2000 (9%), but his approval rating collapsed after Hurricane Katrina. The proportion of blacks who thought Mr Bush cared “a lot” about the needs and problems of black people was a mere 1% in September last year, according to a CBS poll. That figure rebounded to 7% in February, but the president remains unusually unpopular among blacks even for a Republican.

Ms Wall retorts that if one looks at individual swing states, the picture is sometimes rosier. In Ohio, Mr Bush doubled his share of the black vote in 2004, to 16%. Winning Ohio won Mr Bush the presidency, in effect, so these things matter. This year Ohio is again up for grabs, with the state Republican Party crippled by scandal. Some Republicans think a six-foot-five former college football star can save them. Mr Blackwell is running for governor on a platform that draws condescending grimaces from the Congressional Black Caucus: low taxes and opposition to abortion and gay marriage. If he can enthuse conservatives and persuade black Democrats either to switch sides or stay at home on polling day, he might, possibly, win.

Even more intriguing is the thought of Condoleezza Rice, Mr Bush's secretary of state (and no relation to Frances Rice), running for president in 2008. Her boosters think she could grab both black and female votes from the Democrats. On the down side, however, she has never run for elective office, has no domestic-policy experience

and says she's not interested.

With the national mood shifting against them, it will be especially hard for Republicans to win votes among blacks in November's elections. Wayne Perryman, a black preacher from Washington state, favours trumpeting the Democrats' racist past. Most blacks don't know that it was Democrats who upheld slavery and segregation, he complains. The Republicans could win votes by educating them. For example, though he admits “this may sound self-serving”, they could distribute copies of Mr Perryman's book, “Unfounded Loyalty: An in-depth look into the blind love affair between blacks and Democrats”.

Harping on history might work, up to a point. But the age of segregationist Democrats ended before most Americans were born. Today, it is Republicans who are distrusted, partly because so many oppose affirmative action, and partly because, as Mr Perryman observes, the people young blacks see coaching sports teams and doing other good works in their communities are almost all Democrats.

Frances Rice offers a counter-example. Newtown, a small and impoverished black area of Sarasota, is starting to recover, she says, thanks to the efforts of Republicans such as herself in getting it designated a “Front Porch Community”, eligible for various types of assistance. The people of Newtown, however, seem reluctant to give the party credit. Alton Dorsey, a 39-year-old self-employed landscaper standing on a dilapidated front porch in Newtown, says he sees Republicans as “a huge elephant that can trample over things; an elephant that steps on the scales of justice and tips them.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Political appointments

Mr Kempthorne goes to Washington

Mar 23rd 2006 | AUSTIN
From The Economist print edition

A grubby job goes to a western governor

Reuters

Nice environment for some

MANY retiring governors, if they are not angling for the White House or the Senate, head for the private sector to make a spot of money. A few other dedicated souls join the president's cabinet, and the latest of these looks likely to be Dirk Kempthorne of Idaho, who was nominated last week to become George Bush's next secretary of the interior. Hearings will probably begin in May. He would replace Gale Norton, who is stepping down after five contentious years.

Mr Kempthorne spent six years in the Senate before his two terms as governor, so he should sail through confirmation. Then the trouble starts as he faces open warfare with greens over land use. Under Ms Norton, the department has favoured opening up public lands for oil and gas drilling, as well as increasing snowmobile access to national parks. Just as controversial are efforts to sell off a vast public acreage to the private sector, though the latest proposals mostly involve Forest Service land, which falls under the Department of Agriculture.

Mr Kempthorne's interest in the job is a bit surprising, notes Steven Hayward of the American Enterprise Institute. To make a real imprint on policy, “you want to come in at the beginning of administrations, not the end of them.” Moreover, his future boss, Mr Bush, is reeling politically, and Washington will be at a standstill in any case until the November elections are over. Cecil Andrus, a four-term Idaho governor who blazed the trail to Interior (he headed the department under Jimmy Carter), predicts that Mr Kempthorne will be hard-pressed to get his own ideas through.

Industry groups are cheering Mr Bush's choice. Tom Partin of the American Forest Resource Council, which is based in Portland, Oregon, and represents lumber companies, calls Mr Kempthorne an “advocate for balanced and sustainable management of our federal lands”. Some Democrats, such as Maria Cantwell, a senator from Washington state, have praised Mr Kempthorne, but most greens are glum. The League of Conservation Voters gives Mr Kempthorne a score of 1% (out of 100%) for his policies while in Congress. He not only supports drilling in the Arctic National Wildlife Refuge, but has also tried to revise the Endangered Species Act.

In Idaho, Mr Kempthorne has helped state parks. But his efforts to deal with toxic waste have fallen short, says Chase Davis, a Sierra Club representative in the north-west. The governor once publicly considered asking the Environmental Protection Agency to leave his state during a row over the clean-up of a huge old mining site. Mr Davis also accuses him of having undermined efforts to save the wild salmon in the north-west. He hopes that, since Mr Kempthorne is from Idaho, he will support a prospective bill to protect the vast and beautiful Owyhee Canyonlands in the state's south-west, one of the last big undesignated wilderness sites in the lower 48. But overall, he says gloomily, “We're not going to see much difference” from Ms Norton's days.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com
WORLD
NORTH AMERICA
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

The Illinois governor's race

Punches and Judy

Mar 23rd 2006 | CHICAGO
From The Economist print edition

A moderate Republican now faces a much tougher battle

IT MAY be the Land of Lincoln, but it is a long time since Illinois had a leader of Honest Abe's reputation. Four of the state's governors have been indicted in the past half-century, and federal investigators are now looking into ties between fundraising by the current governor, Rod Blagojevich, a Democrat, and the awarding of state contracts. Unfortunately for Mr Blagojevich's Republican challenger, Judy Baar Topinka, the state treasurer, her own party may be too damaged by infighting and past scandals to mount a serious challenge. Having won the nomination on March 21st, in a bitter and surprisingly close primary race, she now must find a way to circle her party's wagons.

In a field crowded with conservatives, Mrs Topinka won only 38% of the Republican vote. Her moderate stance on many social issues (she favours abortion choice, for example) clearly hurt her in the voting. Jim Edgar, a former governor who backed Mrs Topinka, complained that many moderate Republicans—unlike committed conservatives—failed to turn out and vote, a refrain that centrist Republicans across the country have been singing sadly for many years.

Rows over social issues are only part of the story, however. The party, after all, has long been able to plaster over this rift in other races. What has set Illinois Republicans at each other's throats recently is corruption. The party has been in disarray since 2003, when Mr Blagojevich's Republican predecessor, George Ryan, was indicted on 22 counts of conspiracy and fraud. Mrs Topinka's detractors complain that, because she served alongside Mr Ryan as treasurer, she will be unable to exploit the ethical cloud hanging over Mr Blagojevich.

Indeed, her Republican primary challengers did their best to tie her to Mr Ryan, whose trial coincided with the later stages of the campaign. The jury began deliberating a week before the primary, and was still pondering the former governor's fate as *The Economist* went to press (the jurors no doubt trying to work out how Mr Ryan could have enjoyed such a splendid lifestyle while spending as little as $77 a year of his own cash). Mrs Topinka's closest challenger, Jim Oberweis, ran a television ad of her dancing with Mr Ryan, calling it the “pay to play polka”.

Yet while these attacks will damage her, Mrs Topinka is in other ways the Republican best-placed to exploit Mr Blagojevich's other big weakness: the state budget. She, like many independent experts, has accused the governor of reckless fiscal behaviour. Most notably, he has forecast future savings on pensions payments and counted them as current general revenues.

These accounting gimmicks are the main way, says Mrs Topinka, in which Mr Blagojevich has been able to expand spending on pet social programmes without breaking his pledge to avoid increases in sales or income taxes. Many of these spending schemes are popular: the governor signed a law last year that provides health care for all Illinois children under 19, for example, and now wants to expand access to pre-school. So if the Republicans hope to unseat him, they must convince voters that the free lunch he is offering really is the result of funny numbers.

As a three-term state treasurer, Mrs Topinka has a better chance than anyone of driving that message home. But since her ethics have now been questioned by Republican rivals, and given the investigation hanging over Mr Blagojevich's office, it may not be long before the whole race degenerates into wanton mudslinging. The *Chicago Tribune*, licking its lips, predicts a campaign that will be “absolutely brutal”.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD NORTH AMERICA
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

New York schools

Pennies from heaven

Mar 23rd 2006
From The Economist print edition

Messy politics trumps a court order

A YEAR ago, Leland DeGrasse, a justice of the New York State Supreme Court, issued a decree to save New York City's floundering schools. The state, Mr DeGrasse ordered, must give the city an extra $5.6 billion to run its schools, plus $9.2 billion for construction. Only if this were done, he said, would city students receive a "sound basic education". His order was delivered with legal and moral authority. But New York's leaders are now fighting over school spending ahead of an April 1st budget deadline, the court order largely eclipsed by politics as usual.

School-funding decrees have been wafting down from New York's judicial benches since 1995, when the state Court of Appeals declared a student's right to a "sound basic education". Driven by litigation from the Campaign for Fiscal Equity (CFE), a leftish advocacy group, judges have ruled that the state is depriving the city's students of this basic right and that more money is required.

New York City's school system is indeed struggling. Almost half the students in grades three to eight fail to meet the city's standards in maths or English, and 70% of teenagers attend overcrowded high schools. These problems cannot be blamed entirely on money: despite the best efforts of Michael Bloomberg, New York's mayor, the schools suffer from a bloated bureaucracy and a teachers' union that stifles reforms. What is more, New York already spends more on each student than any other state except New Jersey (whose schools operate under a court decree.) Yet Mr DeGrasse, who does not have to answer to taxpayers, ordered the state to increase operational spending by a whopping 45% over four years. George Pataki, New York's governor, appealed the ruling.

While that case works its way through the court system, Mr Pataki is doing his own thing. His proposed budget includes a "five-year sound basic education plan" that bears no resemblance to the court's. It would raise spending on schools across the state by $634m next year, a fraction of the mandated increase, with only part of that money for the city itself. He also wants to open more charter schools and give $500 tax credits to students stuck in bad districts, to be spent on tutoring or private education—proposals that have sent the teachers' unions into fits and are hotly debated in the state legislature.

The main beneficiary of the CFE order, Mr Bloomberg, is being rather pragmatic about it all. Instead of basing his demands on Mr DeGrasse's neverland of unlimited resources, he wants the state to produce half the cost of a long-term $13.1 billion school-construction plan, and $1.8 billion of that cash this year.

To get this money, Mr Bloomberg is relying on traditional bullying, rather than the courts. His aides have hinted that he would oppose a Republican state senator's re-election—at a time when the Republican hold on the state Senate is weakening—unless the Senate provides funds for school construction. And last month the mayor announced that because of the shortage of state cash, he was being forced to scrap plans for 21 new school buildings, including some in the district of the state Assembly's speaker, Sheldon Silver, a Democrat who supports the CFE decree.

The bullying worked. Earlier this month, the state Senate and Assembly passed separate budget proposals that would, by different means, give the mayor his $1.8 billion for school-building projects. The two houses are now haggling over the details.

One problem, however, is how seriously to take the CFE order. For now, this seems to be a political question, rather than a constitutional one. No politician wants to be seen as shortchanging schools, particularly in an election year. As a result, while the court has ordered more money to be pumped into the city, the Assembly and the Senate are promising to pump money into the entire state. The Assembly would pour an extra $6.8 billion into schools across the state over the next six years, a 42% increase. Joseph Bruno, the majority leader of the Senate, who once called the CFE decree "lunacy", has proposed spending $5.2 billion more on the state's schools over the next five years.

All well and good—if New York state were flush with cash. It isn't. The state has a rare surplus, but this is sure to vanish by next year. Messrs Pataki, Silver and Bruno have each proposed raising spending and slashing taxes. Furthermore, Mr Silver and Mr Bruno have rejected most of the governor's cuts to Medicaid, which devours 35% of spending. The state comptroller has predicted that the governor's budget—which is smaller than that of the Senate

or the Assembly—would create shortfalls of $7.9 billion in fiscal 2007-09 and increase the state's already heavy debt burden. In short, the state is going broke. School funding looks bound to rise, but where the money will come from is less certain.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD NORTH AMERICA
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

The potato industry

Pass the spuds

Mar 23rd 2006 | EAGLE, IDAHO
From The Economist print edition

A pox on diets

AS IDAHO'S vast potato fields emerge from the snow, farmers are fretting about their battered industry. Immediately after the September 11th attacks people stopped going to restaurants—and eating French fries, or even freedom fries. But far worse have been the diets. The obsessively low-carb Atkins diet reduced sales of spuds by 5%, reckons Frank Muir of the Idaho Potato Commission. When Atkins Nutritionals went bankrupt last year, Idaho farmers—who grow about 30% of America's russet potatoes—were jubilant.

Each American eats nearly 135lb (or 61kg) of potatoes each year. Prices have perked up because less acreage is being planted, says Keith Esplin of Potato Growers of Idaho. But growers are not in the clear yet. Although the annual figures for chips and French fries are holding steady, consumption of fresh potatoes per head has been gradually declining. It is now 40% below the level it was 40 years ago, partly because Americans do less cooking at home. To the industry's indignation, a state lawmaker recently proposed removing the “Famous Potatoes” slogan from Idaho's licence-plates.

Ben Hardy, a grower in southern Idaho, is sick of hearing about diets. “Rather than staying with the basics that their parents taught them, [consumers] have to have this miracle cure,” he grumbles. Unable to make enough money in potatoes, he runs a hay-cutting business on the side. Meanwhile, the family potato farm is vanishing. In Mr Hardy's valley, where 30 growers thrived in his father's day, there are now just three. Many have been forced to switch to cattle; others are experimenting with purple and yellow potatoes, beyond the staple russet. But Mr Hardy does not trust the trends. “The guy who bought yellow potatoes last year, he may not like them this year,” he says.

Fuel prices are a big worry. It is not just that Idaho is such a long way from the big coastal markets but also that fuel is the main expense in planting and harvesting. Mr Hardy says that his bill has tripled in three years. Electricity too is getting pricier, and these expenses have offset the rise in potato prices.

Might international markets help? American exports are increasing to Mexico and to Asia, where people have developed a taste for freeze-dried potato flakes. In January, Japan opened its market to “chipping potatoes” (which become potato chips, or “crisps” to Brits).

But even if exports do grow a bit, the main focus of Idaho farmers is still on making American consumers understand their product. A marketing campaign is cranking up, delivering the message: eat potatoes, but exercise too. Mr Potato Head, a longtime industry mascot, is donning running clothes. The Idaho Potato Commission has hired Denise Austin, a blonde fitness guru, to run up and down steps and swoon over spuds—only 100 calories, no fat, and lots of potassium and fibre. Ms Austin has even posed in an Idaho potato sack, looking not unlike the alluring Marilyn Monroe.

Alas, even slick marketing cannot stave off lousy headlines. Last month, McDonald's admitted that its fries had more trans-fat (a bad thing) than previously known. The restaurant has also confessed to having cooked its fries, or chips, with wheat and dairy derivatives, angering people with allergies. For weary growers, this sort of publicity is not small potatoes.

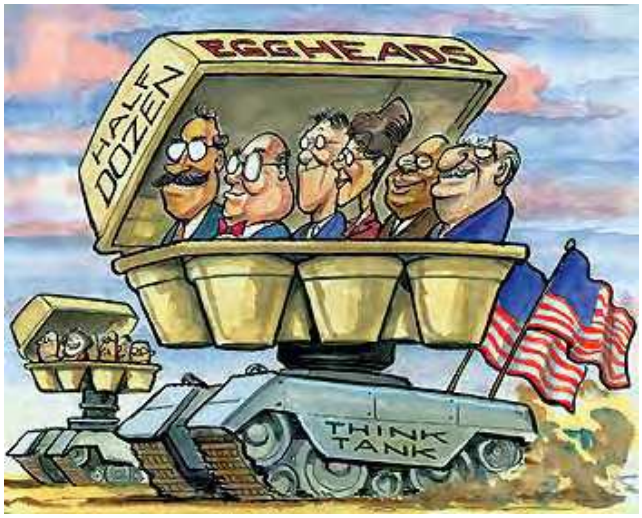
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Lexington

The battle of ideas

Mar 23rd 2006
From The Economist print edition

Public intellectuals are thriving in the United States



ONE of the best passages of “Gulliver's Travels” concerns his visit to the Grand Academy of Lagado. Gulliver is naturally bemused by the schemes of the “projectors” for making life more comfortable: extracting sunbeams out of cucumbers, or training pigs to plough fields with their snouts. But what really shocks him is their “wild impossible chimeras” for fixing politics: “schemes for persuading monarchs to choose favourites upon the score of their wisdom, capacity and virtue; of teaching ministers to consult the public good; of rewarding merit, great abilities and eminent services.”

For much of the past 200 years Europe has been a more natural home of these “projectors” than America. Europe produced both grand visionaries like Marx and compulsive improvers like Bentham; America prided itself on being a businesslike civilisation. Europeans used the word “intellectual” (a French invention, naturally) as a term of praise. Americans regarded it as synonymous with “egghead”, if not “sexual deviant”.

But look at the world of public policy today and it is America that is the land of the intellectuals and Europe that is the intellect-free zone. Look at the Iraq war, and you can see the influence of the dreaded neocons. Look at tax policy, and you can see the influence of the supply-siders. Look at the debate about gender roles and, lo and behold, Harvey Mansfield, Harvard University's lone conservative, has just mounted a heavyweight philosophical defence of “Manliness” (though the references to Aristotle have not stopped Oprah Winfrey from flashing it on the cover of her magazine, next to a smiling picture of herself).

There are few, if any, bolder policy intellectuals than Charles Murray, who is publishing his sixth book, “In Our Hands: A Plan to Replace the Welfare State”, this weekend. Mr Murray has never held either high office or an academic position. Yet he has done more to provoke serious debate on subjects ranging from welfare to IQ than any of the million or so members of American academe, and more to produce changes in America's welfare state than any of the army of professional politicians.

“In Our Hands” marks a return to the subject that first made him famous, welfare reform. In “Losing Ground” (1984) Mr Murray argued that the welfare state had institutionalised rather than alleviated poverty. In his new book he presents a bold proposal to fix welfare. Every year the American government redistributes more than a trillion dollars to pay for retirement, health care and poverty-alleviation, he argues. Yet millions of Americans are still left high and dry. The reason is simple: government screws things up. Why not forget about converting taxes into a muddle of services and subsidies, he asks, and hand out cash grants to all American adults? “Make the grant large enough so that the poor won't be poor, everyone will have enough for a comfortable retirement, and everyone will be able to afford health care. We're rich enough to do it.”

“In Our Hands” raises as many questions as it answers. What happens to people who squander their money either through innate dullness—Mr Murray believes that IQ is partly inherited—or through poor character? And what happens to the children of improvident parents? But it would be foolish to underestimate Mr Murray's ability not just to stir debate but to steer policy: 12 years after “Losing Ground” was dismissed as the work of a wild-eyed fanatic, Congress had passed the welfare reform act.

Just as intriguing as what Mr Murray says is the fact that he says it at all. America now far outclasses Europe in its ability to produce intellectuals with root-and-branch schemes for improving society. There are lots of reasons for this. One is that America is much less consensus-orientated than Europe, especially when it comes to policymaking. In Europe policy is overwhelmingly made by the civil service or by political parties (which tend to be hierarchical and centralised). In America independent policy entrepreneurs have lots of chances to influence it—partly because the civil service is weak and partly because the political process has lots of entry points, from the states to the federal government, from the White House to Congress. Policy intellectuals can bend the ears of congressmen, who are always on the look out for the innovation that will make their name.

Think-tanks and chat-shows

Another reason is that policy intellectuals can make a much better living in America than Europe. America has been fabulously successful at providing its projectors with Grand Academies in the form of lavishly-funded think-tanks, well over 100 of them in Washington alone. And American projectors have been superb at getting their message across. America boasts a vast array of magazines, such as the *American Interest* and the *New Republic*, which like nothing better than picking up “hot” new ideas. And America's policy intellectuals have a talent for packaging their ideas in provocative ways—for declaring not just that the cold war is winding down but that history is ending, not just that regional tensions are rising but that the world is entering a clash of civilisations.

Europe is showing signs of catching on. There may be a big difference between the current hot debate in France—should you give people jobs for life immediately or should you wait for two years—and Mr Murray's vision of killing the welfare state. But Europeans will have no choice but to debate tough questions, about everything from the birth rate to their addiction to regulation. A growing number of Europeans are seeking inspiration in American-style think-tanks (which are spreading across the continent) and in American-style thinkers (Irwin Stelzer, the neo-conservative movement's ambassador to Britain, has already presented an inscribed copy of “In Our Hands” to Gordon Brown). Swift's projectors may soon be flourishing in Europe once again—although this time with an American accent.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Peru

At the double, Ollanta the outsider

Mar 23rd 2006 | LIMA
From The Economist print edition

AFP

A would-be caudillo and an election that is a parable of the dangers in the unfulfilled agenda of Latin American democracy

Get article background

THE candidate of a newly formed Peruvian Nationalist Party, Ollanta Humala bounds onto the rickety stage. Some 3,000 people have gathered in the square in Santa Anita, a lower-middle class Lima suburb poised uneasily between an aspiration to prosperity and the fear of poverty. Dressed in a red T-shirt emblazoned “Love for Peru”, Mr Humala barks out his rabble-rousing message.

He blames big business and “traditional” politicians for the poverty and lack of opportunity that still afflict many Peruvians. He wants a new constitution to allow the state “a role in generating wealth”, to ban foreign (and especially Chilean) companies from “strategic” businesses and “review” past tax breaks given to foreign mining companies to attract investment. “Nationalism is a republic of our sovereignty over our resources that God placed beneath our soil for the benefit of our children and which right now are beyond their reach,” he roars.

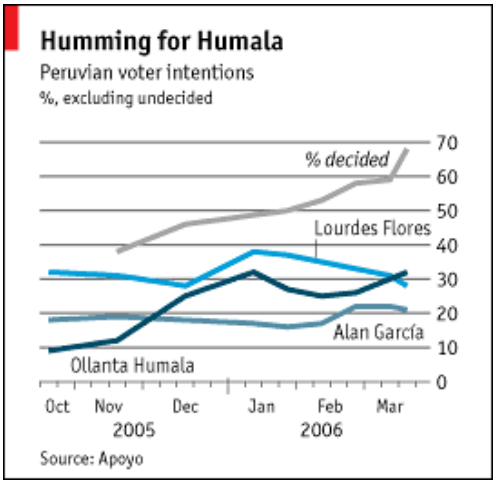
Mr Humala, a former army lieutenant-colonel who was cashiered for rebellion, lacks a coherent manifesto and previous political experience. Yet he now looks the likeliest winner of what is still a close-fought presidential election on April 9th (see chart). What is less clear is whether he might win outright or in a run-off in May.

It would not be the first time that an outsider has snatched Peru's presidency from more illustrious rivals. In 1990, Alberto Fujimori, then a little-known university rector, emerged to defeat Mario Vargas Llosa, a liberal and one of Latin America's best-known writers. But in 1990 Peru's plight was catastrophic: under Alan García, a young populist, hyperinflation and mismanagement shrank the economy, and the Shining Path, a Maoist terrorist group, was running amok. In desperation, Peruvians turned to a fresh face.

What is paradoxical about Mr Humala's rise in the polls is that Peru has been doing well by its recent standards. It recovered democracy in 2000, after the resignation of Mr Fujimori, who had governed for a decade as an elected autocrat. The economy has grown at an average of 5% for the past four years, rising to 6.7% last year.

Some of the growth comes from high world prices for Peru's minerals. There is much debate over how much has trickled down to ordinary people. Officially, poverty has fallen only from 54% in 2001 to 51% in 2004, though the figures are not reliable. Export agriculture,

manufacturing, tourism and construction are all growing impressively and generating jobs. So why is Mr Humala, the self-declared scourge of the status quo, so popular?



The immediate answer is that the other candidates have disappointed. Lourdes Flores, a worthy but dull conservative, has run an energetic campaign. But she has failed to shake off the charge that she represents big business (of which Peru, sadly, has little). Mr García is a skilled political operator, but many Peruvians remember his government, and wince.

If the polls are right, Ms Flores will face Mr Humala in a run-off. Until recently, they suggested she would win this easily. Mr Humala's support dipped in February after claims that he was responsible for disappearances and torture during the “dirty war” against the Shining Path. It has since recovered, while Ms Flores has lost momentum. Apoyo, a polling firm, now suggests that each would get 50% in a run-off. If undecided voters continue to swing behind Mr Humala, he will win.

That prospect has finally shaken complacent foreign investors. Some pundits see Mr Humala as part of a left-wing wave sweeping across Latin America. He is supported by Venezuela's Hugo Chávez and, it is claimed, has been helped by the victory in Bolivia in December of Evo Morales, a socialist of Andean Indian descent.

Mr Humala has raised race as an issue. But he is a typical product of Peru's provincial middle class: he is *mestizo* (of mixed race), speaks no Indian language and went to a private school. His nationalism is that of the populist military *caudillo*. His brother, Antauro, whom he has never publicly criticised, organised a fascist movement of ex-soldiers which in January 2005 briefly seized a small town in the Andes, killing five people. In 2000, as Mr Fujimori's regime collapsed, the two brothers staged a curious military rebellion. Perhaps deliberately, this distracted attention from the flight of Vladimiro Montesinos, Mr Fujimori's notorious intelligence chief.

That Mr Humala has not, so far, swept all before him is proof that some Peruvians do think things have improved. But behind his support is a deep-seated resentment among many others that they are missing out on progress. That is the fault of government—rather than of business or the “neo-liberal” economic model, as Mr Humala claims. Even by regional standards, education and health services are poor in Peru, and infrastructure is lacking.

That failure goes back decades. But Alejandro Toledo, the president since 2001, squandered an unrivalled opportunity. He failed to reform the judiciary, or to cut the armed forces down to size. Despite the growing economy, government anti-poverty programmes are “pathetically poor”, says Richard Webb, a former central-bank governor. “Less than 1% of GDP is spent on them, and it's spent badly.” What Mr Toledo and the outgoing Congress are remembered for, rather, is for having raised their own salaries.

In today's Latin America, neglect of poverty and social programmes is an open invitation to populist outsiders. That Mr Humala may be elected despite—or because of—being loathed by most better-off Peruvians and much of the country's media is a backhanded tribute to democracy. Many poorer Peruvians, especially those in the Andes or who have migrated from there, identify with him. “He's from the provinces, and he's suffered himself, the same as us. He's our brother,” said Rey Carlos Nolasco, a shopkeeper, at the meeting in Santa Anita.

The fear is what Mr Humala would do with power if he gets it. One theory is that he would turn out to be like Lucio Gutiérrez, another former army colonel, who won power in Ecuador in 2002 by campaigning as an outsider, but adopted moderate policies in office before being overthrown for heavy-handedness (see article). Another is that Mr Humala would be a less economically competent and more thuggish version of Mr Fujimori.

Peru retains an authoritarian streak that is vanishing in many other parts of Latin America. The country has seen a transition to democracy every ten years for the past half century, notes Julio Cotler, a sociologist at Lima's Institute for Peruvian Studies. If Mr Humala does win, it is to be hoped that it will not need another one in a few years' time.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Ecuador

Pre-electoral tension

Mar 23rd 2006 | QUITO
From The Economist print edition

Challenges to a weak government

EPA

The heavies come to collect

Get article background

IN 2002, Lucio Gutiérrez, a former army colonel, was elected as Ecuador's president at the head of an alliance including a powerful movement of Andean Indians. Mr Gutiérrez was ousted last April, and the indigenous movement, from which he had long since parted company, is now divided. Even so, both are now making life difficult, in different ways, for the country's interim government.

The more immediate challenge comes from the indigenous groups. On March 21st, the government declared a state of emergency in five highland provinces after several days of protests and roadblocks. The largest Indian body, CONAIE, threatened to occupy Quito, the capital. The government says it will use force to break up the roadblocks.

Ostensibly, the protests are against negotiations for a free-trade agreement with the United States. CONAIE says this would hurt subsistence farmers; it wants a referendum on the matter. But a bigger motive is jockeying by local leaders ahead of a general election due in October. Screwing some extra money from the government is a good way to win office.

Across the country, similar violent protests by local politicians of various stripes have extracted $1 billion in promised extra spending from the government of Alfredo Palacio. The protesters know that official coffers have been swollen by windfall oil revenues.

They also know that although Dr Palacio at first had ambitions to be far more than a caretaker, he is weak and of questionable legitimacy. A cardiologist, he was Mr Gutiérrez's vice-president. He was installed in the top job by Congress and demonstrators, angry after Mr Gutiérrez dissolved the supreme court. The former president was jailed for sedition when he returned home in October after brief exile.

Given his contempt for judicial independence, it was ironic that a court this month freed Mr Gutiérrez, though he still faces other charges. He promptly launched a campaign for the presidency. Polls give him 6% or so, putting him in the top five in a crowded field. He is unlikely to win. But his presence on the campaign trail, together with the Indian roadblocks, is a reminder that Ecuador's government lacks authority, and is little more than a cash machine. Sadly, the election may not change that.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com
WORLD
LATIN AMERICA
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Jamaica

Portia's turn

Mar 23rd 2006 | KINGSTON
From The Economist print edition

New leader, old challenge

SHE is something of a breath of fresh air for a country whose politics has long been dominated by elderly men. Portia Simpson-Miller, who takes over as Jamaica's prime minister on March 30th, is 60, but looks younger and has an easy, magnetic charm. At a leadership convention of the ruling People's National Party (PNP), she narrowly won a delegates' vote to succeed P.J. Patterson, the prime minister since 1992. She did so by winning over the party's grassroots, rather than its establishment figures.

Mrs Simpson-Miller, whose previous ministerial jobs included local government, labour and tourism, takes over at a propitious time. After 30 years of stagnation, the economy may finally be on the turn. Bauxite companies are investing again, wooed by high prices. Spanish-owned hotels are going up on the north coast. Call centres are expanding. A search for offshore oil is under way. Remittances from Jamaicans abroad help, but so do reforms pushed through by Mr Patterson.

After almost two decades in power, the ruling party looks a bit shopsoiled. But its new leader has opened up a 26-point lead in the opinion polls over the opposition Jamaica Labour Party. Local elections due by June will be an early test; a general election may follow soon after.

The bigger test for Mrs Simpson-Miller will be tackling crime and corruption. Since the 1970s, the island has been bedevilled by violence by gangs, many of which are involved in cocaine transhipment. The gang leaders, known as “Dons”, cultivate links with politicians from both parties. The murder rate is amongst the world's highest, with 1,674 killings last year in a country of 2.7m. On March 20th, Peter King, Jamaica's senior trade official, was found murdered in his home in Kingston.

Mrs Simpson-Miller's chief rival for the leadership was Peter Phillips, the national security minister. He has made some progress. The police are buying new forensic equipment and the defence force at last has some serviceable patrol boats. This year has seen fewer murders so far. Whether a background in the rough world of inner-city politics will help or hinder the new leader in the fight against crime remains to be seen.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD LATIN AMERICA
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Corruption in Brazil

House calls

Mar 23rd 2006 | SÃO PAULO
From The Economist print edition

Pressure builds on the finance minister

Get article background

HIS confidence in his finance minister, Antonio Palocci, is “unshakeable”, insisted Brazil's president, Luiz Inácio Lula da Silva, this month. That means, of course, that it may not be for much longer. For months Mr Palocci has been swatting away corruption allegations stemming from his time as mayor of Ribeirão Preto, a city in São Paulo state's sugar belt, and from his management of Lula's 2002 election campaign. Suddenly, some of the claims look more credible and Mr Palocci's denials have grown feebler. He has been the government's most stalwart defender of economic stability and reform. Now his future looks uncertain—just six months before a presidential election in which Lula is almost certain to seek a second term.

Prosecutors in Ribeirão Preto have been investigating whether Mr Palocci financed Lula's Workers' Party (PT) with kickbacks from rubbish collection in 2001-02. In addition, Rogério Buratti, a former senior official in Ribeirão Preto, accused Mr Palocci of taking a donation of 1m reais ($460,000) for Lula's election campaign from bingo entrepreneurs in exchange for promising to legalise the business. But Mr Buratti is himself under investigation.

Now a newspaper claims that Mr Palocci was a frequent visitor to a house in Brasília used by the “Republic of Ribeirão”—the clique Mr Palocci had been distancing himself from—to distribute cash and enjoy the services of female “receptionists”. Mr Palocci denied before a congressional committee—and continues to deny—that he had ever set foot in the house. But the caretaker, Francenildo Santos Costa, told the newspaper he had spotted the minister “ten or 20” times. A driver also claims to have seen Mr Palocci there.

The minister's position was not helped by what looks like an attempt to smear Mr Costa. Leaked records showed deposits of 25,000 reais in his account in the federal savings bank since January. Was he paid to blacken Mr Palocci's name? Maybe not: the money apparently came from the caretaker's father. That does not prove Mr Costa's claims. But now the government is scrambling to explain the illegal disclosure of a citizen's account in a bank controlled by the finance ministry.

The opposition, which has treated Mr Palocci gently, now wants his head, hoping that might hurt Lula's election chances. The PT, which never liked his economic prudence, is rallying round. Lula's faith in his minister is doubtless boosted by the calculation that sacking him, which might expose him to arrest, would be more costly than keeping him.

Financial markets have stayed calm. Mr Palocci's likeliest successor is his deputy, Murilo Portugal, who would continue his policies. His loss would be felt if Lula wins a second term. Mr Palocci champions long-term fiscal reform, which is needed to boost growth. No one else in the PT combines his reformist zeal and clout.

Mr Palocci's woes started as a sideshow to the *mensalão*, a complex scandal concerning payments by the PT to its own congressmen and those of allied parties. A congressional investigative committee is due to report next week, and may provide the most comprehensive account so far of the sleaze. It is expected to allege that state-owned companies were milked for millions paid out to congressmen in return for their votes. The government discovered how “to capture the state”, says Denise Frossard, a member of the committee. Sadly, Mr Palocci is one of the few senior officials who had seemed to understand the difference between the two.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD LATIN AMERICA
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Mexico's postal services

On Mexican time

Mar 23rd 2006 | MEXICO CITY
From The Economist print edition

An improvement from appalling to bad

WANT to pay a bill in Mexico? Go to the bank, and pay it straight into your creditor's bank account. Wish to send a letter across town? Call a messenger. Something for abroad? Use an international courier. As for the state-owned postal service, Sepomex, it evokes a laugh from most Mexicans.

Gonzalo Alarcón, Sepomex's head, says that “delivery times are acceptable”. He seems to be among the few who thinks so. “If you are trying to send a piece of mail from a small city to another small city, may God help you,” says Carlos Casasús, a former official at the transport ministry.

Sepomex is less inefficient than it was. Its annual losses were equal to half its total revenues, but have fallen to 10% even though wages for postmen have doubled in the past five years. But Sepomex has only one automated mail sorting-machine, at Mexico City's airport. Many of the 2m letters and parcels it delivers each day are conveyed by bicycle. It does not help that Sepomex has just 20,000 employees serving 103m people. The United States Postal Service has over 700,000 workers in a country of 300m.

Remarkably, Sepomex retains 60% of Mexico's postal market, with the rest shared by private companies. Constitutionally, Sepomex has a monopoly for letters and small packages, but this is not enforced. Mr Alarcón complains that his private competitors evade paying taxes and workers' benefits. Since the private firms do not have to provide a universal service, they concentrate on business customers and can afford to invest in automation and training.

The government says that 95% of the mail is now delivered within target times—which range from one to ten days. Anecdotal evidence belies this. Marc Chassinat, whose company delivers newspapers and magazines to subscribers, concedes that Sepomex is better than it was. But, he adds, “the chances that [it] will improve enough in 20 years to force me out of business are nil.” Though that provides an opportunity for nimble entrepreneurs, it imposes an uncounted cost on the economy.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Bangladesh and India

A problem shared

Mar 23rd 2006 | DELHI AND DHAKA
From The Economist print edition

The prime minister of Bangladesh wants to improve her country's image

Get article background

ONLY a year ago, Bangladesh's government denied that its Muslim masses harboured a single Islamist extremist. Yet it has recently been rounding them up in large numbers. This has impressed India, its giant neighbour, whose many worries about Bangladesh prominently include the rise of extremism and “Talibanisation”. This week, Khaleda Zia, Bangladesh's prime minister, paid her first visit to India after more than four years in office. Both sides made efforts to mend their habitually prickly relationship. Yet India still doubts the sincerity of Bangladesh's crackdown; and many other gripes still strain the two countries' relations.

In recent months, Bangladesh has suffered many acts of terrorism, which have been blamed on Islamist extremists and claimed at least 30 lives. Last August, in perhaps the most meticulously co-ordinated terrorist operation ever, some 500 tiny bombs were detonated in 63 of Bangladesh's 64 districts over the course of about an hour. A group called the Jamatul Mujahideen Bangladesh (JMB) claimed responsibility for the blasts. The most visible sign of the government's tough new approach was its arrest this month of the leader of the JMB, and of Siddiqul Islam, leader of a group called Jagrata Muslim Janata Bangladesh (JMJB). JMJB had waged a campaign of torture and killing against radical left-wing groups in the north-west of the country. The government says it has captured around 800 JMB members, including five of the seven members of its ruling council, and that it has charged them with sedition. In addition, the courts have so far sentenced 22 bombers to death.

Previously, the governing coalition dominated by Ms Zia's Bangladesh Nationalist Party (BNP) denied that these groups even existed, inviting suspicions that it was somehow complicit in their activities. After all, the BNP relies on the support of two Islamist parties, the Jamaat-e-Islami and the Islami Oikyo Jote, and will do so again in general elections due by next January. Some of the rounded-up militants emerged from these parties' student wings. But now the government argues that it has more or less dealt with the terrorists. There have been no new attacks reported since a string of suicide bombings last December. In Delhi, Ms Zia agreed with Manmohan Singh, her Indian counterpart, that India and Bangladesh are both victims of terrorism and should join hands to fight the menace.

Yet some remain sceptical about Bangladesh's counter-terrorism effort. The country's main opposition party, the Awami League, has called the arrests “stage-managed”, implying that the government had long known where to find the fugitives. This will no doubt worsen already deep-rooted hostilities between the two main parties in the run-up to the election, which, if the past is a guide, will be scarred by violence.

Even after the militants were detained, the American Peace Corps this month suspended operations in Bangladesh, for fear that Americans could be the target of reprisal attacks by the extremist groups. The Institute for Conflict

Management, a Delhi think-tank, estimates that the JMB and JMJB can call on 10,000 full-time activists and 100,000 part-timers.

More broadly, India fears that Bangladesh is turning away from its secular, tolerant traditions towards a more radical Islam. At a demonstration in the south of the country last week against the Danish publication of cartoons of Muhammad, protesters chanted: “Show us the Danes and we will chop off their hands.”

Besides Islamist terrorism, India has other security worries about Bangladesh. It says it is a haven for various insurgent groups fighting Indian rule in its remote north-eastern parts, and that large numbers of illegal Bangladeshi migrants are changing the ethnic and religious character of its eastern border areas.

To deal with that threat, India is building a fence along its 4,000km (2,500 mile) eastern border. But its finance minister, Palaniappan Chidambaram, this week argued that another way of tackling the migration problem would be to help Bangladesh's economy. “What is the point in calling ourselves a regional economic power,” he asked, “if we can't help our neighbours?” India enjoys a big bilateral trade surplus (of about $1.5 billion in 2005). Bangladesh wants duty-free access to India for its exports.

The biggest single boost to economic ties would be a massive $3 billion investment proposed by Tata, an Indian conglomerate, in a linked gas, coal, steel, power and fertiliser project. India argues that since it would buy the output, this project would also help to redress the trade imbalance. But it is bogged down in lengthy negotiations.

Both countries see huge benefits from co-operating. Bangladesh is particularly concerned about arrangements for sharing the waters in the dozens of rivers that link them. And India would like easier transport to its north-eastern states, which are almost completely surrounded by Bangladesh. Geography, like history, should bind the two countries together. Such has been the climate of mutual suspicion that it has instead kept them apart.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD ASIA
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Nepal

Off his head

Mar 23rd 2006 | KATHMANDU
From The Economist print edition

Everyone against the king

EPA

The opposition lifts off

KING GYANENDRA, Nepal's obstinate dictator, appears to be in a tight spot. Disdained abroad, he faces increasingly united opposition at home. This week his principal enemies, the Maoist rebels who control most of Nepal, and an opposition coalition of seven democratic parties, announced that their former loose co-operation was developing into a tactical alliance against the government.

To cement their closeness, reached during two weeks of negotiations in Delhi, the Maoists agreed to end a brief blockade of Kathmandu, and the democratic parties to take the lead in whipping up urban dissent. They have called for a national strike and rally in the capital next month.

Their reasons for co-operation are clear. Since he seized power in a coup last year, King Gyanendra has entrenched the powers of the monarchy and refused to negotiate with either opponent. The rebels, though powerful in the villages, have been unable to land major blows in urban areas; and the parties have seen their largely peaceful protests in cities disrupted by Maoist tactics such as blockades. Neither opposition force was getting anywhere.

With the negotiations in Delhi continuing, further developments in the alliance are expected. The possibility of a tax boycott and perhaps even the creation of a parallel government are under discussion.

Yet the opposition's alliance is one of convenience and fraught with difficulties. As one strategist for the Nepali Congress, the largest of the democratic parties, admitted, the Maoists' interests lie in further polarising Nepali politics, whereas the stated aim of the parties is to build a democratic consensus on the middle ground. The Maoists claim to support multi-party democracy, but as America's ambassador to Nepal has often observed, they may be lying.

The parties also face the possibility of mounting persecution by the government, which accuses them of consorting with terrorists. Indeed, the new crackdown may already have begun: on March 22nd, police in Kathmandu searched the home of Madhav Kumar Nepal, the leader of one of the democratic parties, who is currently under house arrest.

The political parties ruled Nepal corruptly and incompetently for 14 years before King Gyanendra's coup. They have little popular support. To keep up their end of the bargain with the rebels they will therefore have to attract much larger crowds than they have managed so far—and this looks unlikely unless their leaders are changed. Given that, King Gyanendra might actually feel as secure as his public show of insouciance suggests. During a year of autocratic rule, he has not been forced to amend any important policy as a result of pressure at home or abroad. His army is safely garrisoned, inside strong though isolated positions, and the police have so far contained democratic rallies in the towns with minimal violence. Popular activists who might be capable of stirring greater dissent are languishing in jail.

But although King Gyanendra is fortunate in the weakness of his enemies, they are growing in number and in determination. The younger generation of Nepalese politicians is fiercely republican. If the monarchy is to survive the current crisis, the king had better make some friends.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Japan

Koizumi's last days

Mar 23rd 2006 | TOKYO
From The Economist print edition

Pain for the prime minister, but no gain for the opposition

NOT long ago the authority of Junichiro Koizumi, Japan's prime minister, looked unassailable. He had risked all on a general election last September to gain backing for his programme of deregulation and a smaller state, and seen his ruling Liberal Democratic Party (LDP) romp home with a two-thirds majority. Not only had Mr Koizumi trounced the opposition Democratic Party of Japan (DPJ), he had also destroyed much of the conservative opposition within his own party.

But Mr Koizumi's ability to exploit his triumph has been dwindling rapidly this year. Part of the prime minister's entertainment value lay in his jousting with conservative opponents; now that most of them are no more, his popularity has fallen. More serious, perhaps, is that a number of recent scandals have become associated with Koizumi-style deregulation. First was an uproar over an architect who faked earthquake-resistance data for new condominium buildings—something he would not have been able to do before inspection standards were changed in the late 1990s. This has left a lot of new homeowners wondering about the soundness of their properties. Shortly after this scandal broke, the government lifted a ban on American beef imports, imposed two years ago during a scare over mad-cow disease. Alas, one of the first new shipments of American beef turned out to include banned bits of bone, for which lax inspection has been blamed.

Another scandal is a bid-rigging furore at the Japan Defence Agency. But the biggest of all was the sudden unravelling of livedoor, an internet high-flyer, with the arrest of its young boss, Takafumi Horie. Mr Horie ran for parliament last September in support of Mr Koizumi, who has now been linked by his enemies with Mr Horie's style of buccaneer capitalism.

With tumbling approval ratings for Mr Koizumi and his cabinet, the cumulative effect of these scandals has been to erode the prime minister's political authority well before he is due to step down in September. The clearest instance of this was defeat for an initiative he had been promising since taking power in 2001: an overhaul of Japan's road-building. In 1999 the usual cabal of politicians, bureaucrats and construction companies conspired to get approval to build 9,000km (5,600 miles) of expressways—with taxpayers' money—which even the transport ministry said were not needed. And yet, a committee put in charge of road reforms by Mr Koizumi recently ruled that nearly all expressways under construction should be finished. Total cost to the taxpayer: ¥3 trillion ($25.6 billion).

As striking as the slide in Mr Koizumi's authority is the DPJ's inability to profit from it. Indeed, the opposition may regret the livedoor uproar more than Mr Koizumi and his allies. Last month in parliament a young DPJ lawmaker, Hisayasu Nagata, flourished a copy of an e-mail which he claimed proved money ties between the disgraced Mr Horie and the family of the LDP's secretary-general, Tsutomu Takebe. Emboldened, the DPJ's leader, Seiji Maehara, proceeded to launch an attack on Mr Koizumi himself. But when challenged to prove the e-mail's authenticity, Mr Nagata admitted that it was, in fact, a fake. Mr Nagata comes before the parliament's disciplinary committee this week. But his party is resisting calls for his resignation, presumably fearing that Mr Maehara would have to go too. Mr Maehara has led the opposition for six months and is expected to continue to do so until his party holds leadership elections in September. He is unlikely to last beyond that.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Singapore

Self-replicating

Mar 23rd 2006 | SINGAPORE
From The Economist print edition

Reuters

The city-state's solution to its lack of space

SINGAPOREAN officials had a bold proposition for their Indonesian counterparts at a top-level meeting on March 18th: why not let us “manage” one of your islands? Indonesia, after all, has so many islands—17,500 or so—that it has failed even to name, let alone govern, many of them. And Singapore, with its 4.4m inhabitants, is desperately short of space.

The Indonesian isle that Singapore is most interested in is Bintan, just a short ferry ride away (see map below). Singaporean firms have already built a string of fancy resorts and a few factories there. But, according to the latest idea, the government would ensure that buckets more Singaporean money would be spent on turning much of the rest of the island into a giant industrial park, which would be run like a clone of the rich and successful city-state.

Even if the proposal is smiled on, it may be some time, given Indonesia's glacial official decision-making, before it could happen. But it seems to make good sense: Singapore is one of Asia's most successful industrialisers, with a reputation for efficient and honest administration. However, squashed onto an area of 683 sq kms (266 sq miles), it has a dire shortage of space. It has already expanded its area by around 10% through Dutch-style schemes to reclaim land from the sea; but it is running out of scope to reclaim more. Indonesia, on the other hand, is desperate to attract more industrial investment, seeing it as the key to cutting its worrying unemployment rate. Why not bring in Singaporeans to do the job?

This might sound familiar to students of Singapore's “state entrepreneurship”. In the Asian boom of the early 1990s, the government threaded a necklace of mini-Singapores in investment-hungry countries across the region, from China to India. It also built developments—albeit on a much smaller scale than is now being envisaged—on Bintan and another nearby Indonesian island, Batam. In return for being given a degree of freedom from some local regulations and trade tariffs, Singapore built factories and brought in domestic and multinational firms to occupy them. It also provided telecommunications links, roads, electricity generators and even pension schemes for their workers. And above all, it installed the “Singaporean operating system”, its trademark high-quality administration.

Singapore's government hoped to make juicy profits from selling and renting property, and from charging management fees, in its cloned mini-states. They got off to a good start, with lots of companies signing up. But then came the 1997 Asian financial crisis and investment in the region's manufacturing slumped. The biggest Singapore-clone, at Suzhou near Shanghai, was also hit by fierce competition from a cut-price version that China set up alongside it. As a result of these setbacks, the returns on the clones have been paltry considering the money Singapore put into them, says Alex Pereira of Singapore's National University.

Singapore has nonetheless continued to expand its necklace of industrial parks across Asia, but more cautiously. There is now one in the Philippines, for instance, and several more in India. Having got its fingers

burned in China, Singapore's government is insisting that future expansion, to Bintan and elsewhere, must be led by the private sector—though it seems likely that the firms involved would be ones in which the government is the main or only shareholder. The government realises, says Mr Pereira, that Singapore's high land and labour costs, caused by shortages of space and people, will in time force most of its manufacturers to flee to cheaper neighbouring countries. But if it can get there first, and build the factories and infrastructure they will need, it should at least be able to carry on making some money from them.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Iraq

Murder is certain

Mar 23rd 2006 | BAGHDAD AND RAMADI
From The Economist print edition

AFP

Three years after America invaded, Iraq is as violent as ever

Get article background

AN AMERICAN marine spotted the bomb, in the semi-dark, 30 yards away. A small grey lump in the roadside, half-covered with brown dirt, it looked no different from the moraines of trash and detritus littering Ramadi, the capital of western Iraq's Anbar province—except that it had not been there ten minutes before. The Humvee jeep jolted to a halt, three marines sprang out and grabbed three youths sauntering away.

They possessed nothing suspicious—no mobile phone or radio transmitter rigged to trigger a blast—and were released. But quite possibly they had been trying to kill the marines and your correspondent. Or, at least, if they had not planted the bomb, a 122mm-artillery shell, they must have seen who had. Debating this, the marines took possession of a nearby house—to the alarm of its sleep-befuddled owners—and awaited bomb disposers. The flash and crashing boom of the controlled detonation that followed was not the last, or the biggest, explosion in Ramadi that night.

Three years after America and its few allies invaded Iraq, the incident illustrates one or two features of the war that continues there. America's 138,000 troops in Iraq, already adept and courageous conventional fighters, are much improved at fighting irregularly. This is a benefit of experience: half the marines in Ramadi, aged about 21 on average, are on their second six-month tour of Iraq, and some are on their third. It is also the result of improved tactics and technology. American snipers, hidden on rooftops above main intersections and other likely spots for roadside bombs, known as improvised explosive devices (IEDs), have killed scores of bombers in recent months. New jammers, fitted on to American vehicles, can counteract some remote triggers for IEDs, forcing bombers to revert to cruder and riskier devices, such as command-wires. The Americans now reckon that they foil about 40% of IEDs.

But that still leaves an awful lot of explosions. Indeed, despite the Americans' successes, the rate of IED attacks has remained fairly steady in recent months, at between 60 and 70 a month. And the insurgents have got better also, by using their own snipers, for example, and by planting bigger and deadlier bombs. Of 2,300 American troops killed in Iraq, roughly a third have been dispatched by IEDs. In the past year, over half were killed by IEDs, including 36 of the 55 American servicemen killed last month. Total insurgent attacks—on American and allied troops, Iraqi security forces (ISF) and civilians—have also stayed steady, at around 550 a week.

These figures conceal important variations. For most of the time in this conflict, the violence has been massively concentrated in four of Iraq's 18 provinces—Baghdad, Ninewa, Salaheddin and Anbar—where only 40% of Iraqis live. One reason is that these provinces are home to most of the country's Sunni Arab minority, many of whose

tribes profited from Saddam Hussein's rule, and have resisted America's invasion and the Shia ascendancy it has instigated. Increased enthusiasm for Wahhabism, an extreme form of Sunni Islamism, in the latter years of Mr Hussein's rule, has given coherence and inspiration to this resistance. Even within these provinces, there are variations in the intensity and flavour of the conflict. But the bottom line is that, overall, Iraq is as violent now as at almost any time since the invasion.

This is despite the fact that over the past three years American and British troops have killed thousands of suspected insurgents. They have also detained more than 100,000 Iraqi men, most of them innocent, with only 15,000 still in custody. Such smash-and-grab tactics have clearly failed. “If you've applied the kinetics [Pentagon-speak for force] we've applied, and you still have a situation where attacks are up and there are so many bad guys, that's the best argument against applying kinetics,” says Lieut-General Peter Chiarelli, the commander of coalition forces in Iraq. “For every one we pick off the streets, we're creating one to take his place.”

That may be especially true when the people picked off are innocent. In each of the past three years, according to coalition sources, American troops have killed over 250 innocent people at vehicle checkpoints alone. Given that insurgents often use suicide car bombs, American troops are bound to be jumpy. Yet it is remarkable that coalition procedures for issuing warnings to oncoming vehicles, including flares and shots, were standardised only this month. Last month, for no easily comprehensible reason, American soldiers fired high-velocity shots into the windscreen and engine of a car carrying a Canadian diplomat—inside Baghdad's heavily fortified international zone. And this week American investigators arrived in Iraq to look into the allegedly deliberate killing last November of 15 Iraqi civilians in the western town of Haditha.

As the Americans tend not to report the civilians they kill, many are omitted from independent counts of Iraqi civilians killed in the conflict. Otherwise, by one estimate, the conflict has claimed between 34,000 and 38,000 people so far.

Over to the Iraqis?

More happily, America is no longer trying to win in Iraq by military might alone. The strategy is now twofold: to train, by the end of 2007, Iraqi forces capable of waging the counter-insurgency campaign with little American support; and to create, by the end of 2009, effective civilian institutions under a democratic and representative government. On both fronts there has been progress, but it remains patchy.

The current batch of Iraqi soldiers and police began to be recruited only 18 months ago, after most of the previous lot ran away or joined the insurgency. In that short time, with inspired leadership and American logistics, an army of more than 100,000 soldiers has been trained and equipped. This is a great achievement. With varying degrees of success, the Iraqi Ministry of Defence is paying, feeding and supplying them; and by the end of this year, it is supposed to have full control of the army's promotions and recruitment. At its full complement, the army should have 130,000 men, arrayed in ten divisions, in control of most of Iraq.

When the numbers are set against the soldiers' actual performance, however, this plan looks either hugely ambitious or plainly fanciful. Iraqi troops are often ill-disciplined and accident-prone. The Americans seconded to them as mentors, ten at each battalion and brigade level, joke weakly that ISF stands for I Shot Foot—a painful eventuality witnessed in Ramadi by this correspondent. Asked to assess the first Iraqi tank battalion, one homebound American trainer blanched and muttered darkly. Your correspondent later observed this trainer's former charges rumbling through Baghdad, with one gunner atop communicating with his driver by firing a Kalashnikov rifle over his head.

Still, rough as it seems, this army is perhaps as good as Iraq can expect. The police, under the Ministry of Interior, are in a much worse state—and it is they who are expected eventually to quell the insurgency. So far, 123,000 have been trained and equipped (a total of 194,000 has been authorised). But they are of wildly mixed quality, with some of them barely trained. Worse, the best units, including several paramilitary brigades, have been infiltrated by various brutish Shia militias, and have launched reprisal attacks against Sunni civilians.

In November, American troops freed 123 famished Sunnis, some of whom had been tortured, from an interior-ministry basement in Baghdad. Coalition troops have also been attacked by the boys in blue, with several especially lethal IED attacks against British troops in Basra believed to be the work of rogue policemen there. In western Baghdad last month, shortly after the bombing of a sacred Shia shrine in Samarra, two American soldiers were sliced into pieces by an IED laid, during a curfew, within 50 yards of a police checkpoint.

In nearby Abu Ghraib, amid shady date palms and well-watered fields, a group of Sunni farmers claims that many of their relatives had been killed by Shia assassins within the police. Such tales are no doubt exaggerated. Yet, at a time of appalling sectarian tension, many Sunnis seem to believe them. The farmers said they would prefer to have the Shia-dominated army, or even American forces, in their area than the police. This anything-but-the-police preference should not be confused with America winning Iraqi hearts and minds.

The army's most capable soldiers may be from the Kurdish north,

drawing on seasoned *peshmerga* militiamen. These troops—and occasionally *peshmerga* who are not in the army—have helped bring semi-control to parts of Ninewa, including the ethnically mixed capital, Mosul, and the radicalised Turkomen town of Tal Afar. But the most sophisticated Iraqi units are in Baghdad, half of which is, a bit more than nominally, controlled by four independent Iraqi brigades.

In western Baghdad, two of these brigades, comprising five battalions, are praised by their American mentors. The commander of one, Brigadier Jaleel Khalaf, describes his impressive response to the Samarra shrine-blast: he put guards outside mosques, brokered talks between religious leaders, and so on. His troops have improved security; though IEDs still riddle their area, they tend to be laid hastily and badly—a process American troops dismiss as “drop-and-pop”.

Since the Iraqis took charge, the American brigade has pushed westward into a neglected rural area, Agar Guf. Sunni farmers there complained that the Americans had come with no money to fix roads destroyed by IEDs, and were too few to provide security. Agreeing, a young American lieutenant told them to protect themselves by keeping rifles to hand. “I don't understand why I keep finding your weapons hidden under your beds,” he added.

Yet the farmers may not be bothered for long. The American brigade, totalling 4,000 troops, will leave Iraq at the end of this year. In its place will remain a few hundred American troops—trainers seconded to the two Iraqi brigades, and troops to protect and support the trainers. This is the coalition's withdrawal strategy. According to current plans, which could be revised, no more than 100,000 American forces should be in Iraq by the end of the year. In the south, the current force of 7,800 British troops should have been halved by then, and two desert provinces, Muthanna and Maysan, should be substantially Iraqi-run. Against a shifting insurgency, it is a risky strategy. The Iraqi troops in western Baghdad would not patrol so freely in Baghdad's violent southern approaches, which American troops barely control now. But even that wild area is serene compared with Ramadi.

Returning to Anbar's capital, a city of 400,000, after a year's interval, *The Economist* saw a great deal of violence and little to celebrate. American armoured vehicles slalom at breakneck speeds between sinisterly pot-holed roads. To try to reduce IEDs, a section of the city's main thoroughfare is closed to civilians, shops are boarded-up along it and buildings are derelict. At least the provincial government exists, unlike a year ago, but it hardly functions. On one afternoon of your correspondent's visit, its headquarters was attacked by a dozen insurgents with rockets and machineguns. They were eventually silenced by an American airstrike. Anbar's governor, Mamoun Rasheed, was philosophical about the conflict. “What you are seeing is the struggle between good and evil,” he said. “It has existed since the beginning of time and it will never end.”

Depressing as Ramadi is, it does at least have four Iraqi army battalions, although still no regular police. But even a dozen army battalions could not hope to quash the insurgency—as a night-patrol with an Iraqi company, along the northern shore of the Euphrates river, suggested. After ten months of American training and mentoring, the men of the 3rd battalion of the 1st brigade of the Iraqi 7th division are among the best Iraqi troops in Anbar. Under the haggard eye of a few American troops, their ragtag patrols have improved security in Ramadi's northern outskirt of Jazeera, even if many of the local insurgents have perhaps shifted to other neighbourhoods. The Iraqi soldiers, with their knowledge of Arabic and local customs, do seem more at ease in Ramadi than Americans—but only just. They are all Shia, from Baghdad and Basra, a fact bitterly resented by the inhabitants of Ramadi. Out of earshot of their American mentors, several of the Iraqi soldiers expressed the opinion that the Americans should quit Iraq at once, but added that they would quit the army if they did. Some said they believed that the Mahdi, a mythical figure who, it is prophesied, will lead Muslims to conquer the world before the day of judgment, had recently appeared in Iraq. Several identified him as Muqtada al-Sadr, a firebrand Shia cleric whose black-robed militiamen have killed many American and British troops.

Why is it so difficult to raise disciplined and determined Iraqi troops? Talk of the Mahdi, implying a hankering for leadership, offers a clue. During the invasion, Iraq's state collapsed. Three years on, after a clueless American military occupation and two incompetent and divisive Iraqi governments, it has not yet been rebuilt. Iraqis are more insecure than before the invasion. They also, despite $20 billion thrown at reconstruction projects, have fewer basic services, including power and clean water—Baghdad has 20% less power than a year ago. And where the insurgency rages, their streets are a nightmare of bomb-blasts and rubble. This has made them resentful and distrustful of America's schemes, including the creation of the ISF. Many Iraqis ask how it is that America, which could seize their country in two weeks, cannot turn their lights back on.

Dispassionate observers note that America never expected to have to do so. Its post-war plan, such as it was, was for Iraqis to sort such things out for themselves. Efforts to raise the ISF and do proper reconstruction are still mired in the mess created by the invaders' initial naivety. And still the occupation fails to match power with responsibility. In southern Iraq, for example, British troops are too few to impose control; but too many to convince Iraqis that they are not under foreign control. Each group expects leadership from the other, and meanwhile Basra's streets run with slurry.

A multiple insurgency

America's preferred solution to this problem has been to hold elections to unite Iraqis behind a representative government of their own and against the insurgency. Yet, despite a high turnout across Iraq in December's elections, the violence is undiminished. One reason for this may be that Iraq is not in the throes of a single insurgency, but three distinct although often overlapping conflicts. One battle is for political power. This is drawn on sectarian and, at the local level, tribal lines, and has been stirred by the scramble for power and resources that the elections represent. As elsewhere in the Muslim world, when Iraq's state collapsed, religious and tribal entities filled the void. Among the well-organised Shia majority, Shia militias, including Mr Sadr's, have thrived. In two elections and a referendum last year, Iraqis voted along increasingly sectarian lines, in effect giving power to Shia militia leaders, and, to a much lesser degree, to Sunni politicians linked to the insurgency. Unsurprisingly, then, democracy in Iraq is not peaceful. Shia militias linked to senior ministers were involved in the surge of sectarian killing that followed the recent desecration in Samarra. This bloodshed will not stop till the militias are disarmed.

Iraq's two other conflicts are even more tightly interwoven. The first features disgruntled Sunnis, including many security officials of the old regime, who are fighting foreign occupation and a Shia government, in a vain bid to restore their minority to power. The second fight is that of jihadists aiming to create an Islamist state. Most are Iraqis, with a minority of foreigners among them, including the Jordanian terrorist, Abu Musab al-Zarqawi.

Both these conflicts have been slightly damped down by American military action in recent months. A series of aggressive American operations along the western Euphrates valley late last year, from Ramadi to Qaim, near the border with Syria, has imposed fragile control on several rebellious towns. In the process, Mr Zarqawi's and other extremist groups appear, however temporarily, to have been weakened; they seem less able, for example, to import wide-eyed foreign suicide bombers through Syria.

Cheered by this, American officials claim that many Sunnis have also quit the insurgency since the election, in which they turned out in numbers and won many seats. Americans note the unprecedented recent recruitment of 1,000 Ramadians into the police. This may not indicate much change of heart. One teenage recruit, Leoay Ibrahim, says simply that he needs the police wage of $250 a month. But he also says that most of his male relatives have been detained as insurgents by American troops. Election day in Ramadi saw not a single attack, yet the city has returned to violent resistance. Many voters are clearly keeping their options open.

In the meantime, the violence will continue. It would help if a broad-based government were formed. Hopes of this were raised this week, after Ayatollah Khamenei, the supreme spiritual leader of Iran, which holds great sway with Shia parties in Iraq, agreed to discuss the situation there with America. But no Iraqi government could end the violence soon: the country contains too many unsettled scores and too many angry people.

Neither success nor failure is certain, but any improvement will be slow. On a toilet-wall in an American airbase in western Iraq, an American soldier has scrawled his own summary analysis: “We came, we saw, we wasted a year of our lives. At least we got the fuckers to vote.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Press freedom in east Africa

Hear no evil

Mar 23rd 2006 | ADDIS ABABA, ENTEBBE AND NAIROBI
From The Economist print edition

The reasons for our correspondent's explusion from Uganda

FOLLOWING the victory of Yoweri Museveni in the recent presidential election in Uganda, this newspaper's correspondent there, Blake Lambert, has been thrown out of the country. Apart from being bad news for Mr Lambert, a Canadian who had spent nearly three years reporting from Uganda for *The Economist* and others, it is even worse news for Ugandan journalists. The message to them is clear: any reporter picking at the competence of Mr Museveni's administration can expect something rather nastier than a brusque cheerio at Entebbe airport, such as Mr Lambert experienced. As a government minister warned the assembled correspondents at a press conference to explain Mr Lambert's expulsion: “You are vulnerable people in this country. In case of any trouble caused as a result of bad reporting, you will not be spared.”

Mr Lambert says that the Canadian authorities seemed unconcerned by his expulsion. But a series of complaints from other diplomats forced the Ugandan government to offer reasons for his removal. They gave three. One is that he had no valid work permit, a Kafkaesque charge since the permit was dependent on a press accreditation that was not forthcoming. Another was that he was a danger to national security, a vague and insidious charge that has yet to be substantiated in any way. The third reason was that the government did not like the tone of Mr Lambert's reporting, finding it “prejudicial” to Uganda's national interests. In other words, critical.

Mr Lambert's treatment signals a wider attempt by Mr Museveni to muzzle the press. Will Ross, the BBC correspondent in Kampala, is liked by many Ugandans for his precise and fluent reporting. He has had his press accreditation cut from one year to four months. Andrew Mwenda, the political editor of the opposition-leaning *Daily Monitor*, who hosts a radio show on which Mr Lambert regularly appeared and which is often very critical of Mr Museveni, faces charges of sedition and promoting sectarianism.

It is not just Uganda. The press is being curbed in much of east Africa. On March 2nd police commandos stormed the *Standard*, one of Kenya's two main daily newspapers, roughed up security guards and journalists, removed computers, and burned that day's edition of the newspaper. That assault was ordered by Kenya's security minister, John Michuki, who claimed that it was both legal and carried out in the interests of national security. A more plausible reason is that the *Standard* was investigating a relationship between government officials and drug smugglers. Whatever the truth, the raid had the opposite of its intended effect, appalling a lot of Kenyans, rallying the fractious local media and eroding even further the government's dwindling credibility.

The most brutal treatment of journalists in the region is in Eritrea, which has no press freedom of any kind, and in Ethiopia. According to the Committee for the Protection of Journalists, a New York-based pressure group, 15 Eritrean journalists languish in jail in appalling conditions and with little hope of release; all privately owned newspapers were shut down there in 2001.

As for Ethiopia, Meles Zenawi, the prime minister, has promised a fair trial for 13 or more reporters who are in detention on charges of treason and genocide arising from protests following a disputed general election last May. Mr Meles says that he wants a dialogue with Ethiopia's privately owned newspapers, no matter what they print. But the reality is that press freedom in Ethiopia has suffered since the election. Those dissent-minded editors who are still at large work under threat of harassment, and two foreign reporters have been expelled from the country since the beginning of the year.

The press in east Africa is not without its faults. Some journalists take bribes or incite violence for political ends, as governments allege. But the interference with reporting across the region is still worrying. Mr Museveni is starting a new term of office—and his 20th year in power—on an ominously repressive note.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

War crimes

Bad news for Africa's warlords

Mar 23rd 2006
From The Economist print edition

Two steps forward for international justice

IT HAS been a good week for international justice. On March 17th, the chances of Charles Taylor, former Liberian president and notorious warlord, being brought to justice rose dramatically after Liberia formally requested his extradition from Nigeria, where he has lived in exile since 2003. The same day, the International Criminal Court (ICC), the world's first permanent war-crimes tribunal, made its first arrest. Thomas Lubanga Dyilo, a Congolese warlord accused of conscripting child soldiers, was transferred to the court in The Hague after his arrest in Congo.

When Mr Taylor was first charged three years ago by the UN-backed Special Court for Sierra Leone for his part in that country's savage civil war, few believed he would ever be caught. After Slobodan Milosevic, the late Serbian president, the Liberian leader was only the second serving head of state to be indicted with war crimes since the Nuremberg trial of Admiral Dönitz, Germany's short-lived leader in 1945.

As part of a deal to end Liberia's own 14-year civil war, Nigeria's president, Olusegun Obasanjo, agreed to grant Mr Taylor asylum on condition that he cease meddling in politics in the region—a condition he has repeatedly broken. But, despite mounting international pressure for the Liberian leader's transfer to the court, Mr Obasanjo has always refused to hand him over unless specifically requested to do so by a democratically elected Liberian government. This, Ellen Johnson-Sirleaf, Liberia's newly elected president, has now asked him to do.

It is a brave move. While desperate for international aid to support the reconstruction of her devastated country, she knows that Liberia's fragile peace could be shattered by the thousands of Taylor supporters still in the country. Mr Obasanjo says he must first consult the leaders of the African Union and ECOWAS, a west African regional group, before deciding on Mr Taylor's fate. But the noose is tightening.

Meanwhile, the ICC's arrest of Mr Lubanga, leader of the Union of Congolese Patriots, one of the most dangerous militias in Congo's war-torn Ituri region, has strengthened the credibility of the fledgling international court, which is still fiercely opposed by America. Further arrests relating to the Congolese conflict are expected soon.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

French protests

The phoney revolution

Mar 23rd 2006 | PARIS
From The Economist print edition

The pressure is building on a fretful government that is now worrying about the effects of street protests on next year's elections

"IN FRANCE, reform appears to be against our nature; only revolution seems capable of overcoming inertia and imposing renewal." So wrote Dominique de Villepin, France's prime minister, in a book a few years ago. As the country prepares for nationwide strikes on March 28th, after weeks of student marches and clashes with riot police, his words are sobering. The running protests now have the makings of the intractable street rebellion that every French prime minister fears.

On the face of it, this is a single-issue protest against the first job contract for under 26-year-olds, known as the CPE. Devised by Mr de Villepin, it is meant to encourage employers to hire youngsters by making it easier to fire them during a two-year trial period; after that the contract becomes permanent. The idea is to cut unemployment, which is 9.6% of the overall workforce and 23% among the young.

Certainly, students' resistance to a contract they believe entrenches insecurity has dominated the protests. As many as 1.5m people demonstrated on March 18th, ending with police firing tear gas and water cannons, and making some 170 arrests. One injured protester was taken into intensive care. But most violence has been provoked by a few non-student troublemakers. Many student marches and sit-ins have had an air of festival, not defiance.

But the movement is now broadening. Train drivers, teachers and civil servants are ready to strike over a contract that has strictly no bearing on them: it touches only the private sector, and those under 26. The protest is becoming a howl of rejection against the ruling elite, part of a pattern of such outbursts over the past five years. In the 11th year of Jacques Chirac's presidency, there is a mood of what the French call *ras-le-bol*, or disgruntlement. It might be summed up as: we fear change, France is in decline, our children face an uncertain future, and we have no faith in the political class's ability to deal with all this.

This rejectionist sentiment has erupted in different ways in recent times. A snub to the political elite was in part behind the vote that propelled the far-right Jean-Marie le Pen into the second round of the 2002 presidential election. Protest marked the regional elections in 2004, when the opposition Socialists swept the board, as well as last year's rejection of the European Union constitution. As one observer said then, "the French were ready to say no, no matter what the question."

So far, so peaceful. But the rioters on rough suburban housing estates last autumn chose street rebellion, not ballot-box protest. France has a long, often romanticised, history of preferring the street to parliament as a theatre of protest. To some extent, Mr de Villepin, an unelected ex-diplomat, legitimised this choice when he pushed through the CPE by decree, without consulting the unions or allowing a parliamentary debate. Usually, French protests cause more frustration and traffic jams than bloodied heads. This time, one fear is that the sight of riot police back on the streets only two months after the government lifted its state of emergency could rekindle

trouble in the *banlieues*.

There is a large irony in the brewing revolt which distinguishes it sharply from May 1968, for all the students' self-conscious attempts to re-enact those events, with graffiti copied from history books and the Sorbonne as a rallying point. Then, the rebellion was similarly against a complacent elite. But it was also an idealistic call for change: for a more liberal, permissive society. This time, the revolt is not only against change, since the protesters are fighting to cling to a world of secure jobs. It is in fact against changing an imaginary world, since such jobs are no longer available to most young French people—because the rigid labour laws deter employers from creating them.

This confusion, however, also helps to lend the protests their potency. For it unites both those on the inside, such as public-sector workers who fear for their privileges, with students on the outside, who fear losing their natural-born right to a permanent job upon graduating with a diploma in sociology. With a keen eye on next year's presidential election, the Socialists and others on the left have done everything to foster belief in this myth.

How will the contest play out? Mr de Villepin has said repeatedly that he will not back down. He has staked too much of his credibility on the new contract. He is prepared to talk about small changes, such as trimming the two-year probation period or requiring some cause for dismissal, although such concessions risk destroying the appeal of the CPE to potential employers. He has now invited the trade unions to negotiate over these, though it will be hard for either side to back down without losing face.

Deputies from the ruling UMP party are increasingly uneasy. Those close to Nicolas Sarkozy, the interior minister and another presidential hopeful, worry that the confrontation will make it harder for them to push through bolder reforms if their champion is elected. But they also fear that the right may not win at all. “Our chances are no better than about 50:50,” says one. A recent poll puts the left ahead of the right by 51% to 42%. A run-off between Mr Sarkozy and Ségolène Royal, the most popular Socialist, would be a tie, according to a poll in *Le Point*. In an interview with *Paris-Match* Mr Sarkozy has now distanced himself from the prime minister by suggesting that the CPE should be tried out for six months and junked if it proves of no use.

Much will depend on the turn-out next week. For the unions, their credibility depends on beating 1.5m, and causing chaos on the streets. The Communist-backed Confédération Générale du Travail, France's biggest union, holds its congress next month; its leader, Bernard Thibault, will want a show of strength. But exams and holidays approach for students. Non-protesters and protesters alike face the prospect of having to repeat their academic year if their sit-ins continue.

As for Mr de Villepin, his mix of imperiousness, self-belief and political ambition suggests that he will fight it out, keeping the CPE with minimal concessions. “Governments that give in to the temptation to take the easy route cannot hope to govern for the long term,” he wrote in the same book. “The primary mission of a government is to serve, not to please.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Spain and ETA

Peace talk

Mar 23rd 2006 | MADRID
From The Economist print edition

Reasons for caution over ETA's ceasefire declaration

Get article background

AP

Your cuddly new candidates

SO IT finally happened. ETA, the Basque separatist group, this week announced the ceasefire that Spaniards have been expecting for months. The country can now start dreaming of a future without violence—at least for a while. The declaration of a "permanent ceasefire", made by three masked figures on a videotape, was greeted with cautious optimism by the prime minister, José Luis Rodríguez Zapatero. On March 23rd ETA followed its ceasefire announcement by calling for a peaceful solution to the Basque problem.

Yet the Spanish government has good reason to be cautious. ETA has not said that it is ready to hand over its weapons. Nor has it renounced, let alone denounced, the use of violence. There have been previous ETA ceasefires that have come and, lethally, gone. The most recent, in 1998, lasted for just 14 months.

Even so, Mr Zapatero has some reason for satisfaction. He has followed a clear policy of gradually encouraging ETA to lay down its arms and talk. He has won support in the Spanish parliament. And it has been done in the teeth of fierce opposition from the conservative People's Party, and amid accusations of betrayal by some ETA victims.

Basque peace could be a pay-off for Mr Zapatero's softly-softly approach to Spain's most enduring political problem: regional tensions in the Basque country and in Catalonia. His chief weapon has been his majority in the parliament in Madrid. He used it last year to throw out proposals from the Basque regional assembly for a new statute that would have made it a "free associate" with Spain. Now he is using it to negotiate a new Catalan statute of autonomy. Any future Basque settlement will go through the same vetting process.

Mr Zapatero may, however, still stumble, as the road ahead is highly uncertain. ETA might believe that it is now in a position to bargain for things it cannot hope to win. A separate Basque state carved out of four Spanish provinces and a chunk of south-west France is an impossible pipe-dream. ETA will also have to settle for something less than a full right to self-determination.

Moreover, the People's Party may stymie moves towards prisoner releases. Its leader, Mariano Rajoy, did not sound overjoyed about the ceasefire announcement. "The only really important communiqué that ETA could give is one that announces its dissolution," he said.

A much weakened ETA has not killed since May 2003, when two police officers died in a booby-trapped car. However, ETA's internal structure remains a mystery, all the more so as frequent arrests by the Spanish and French police have forced it continually to reorganise its leadership. One important question is still unanswered: is there a hard-line faction (the Real ETA) ready to carry on the fight? ETA has had internal splits before. Mr Zapatero has been giving warnings of a "long and difficult" process ahead. He is surely right to do so.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Belarus's election

A dictator dictates

Mar 23rd 2006 | MINSK
From The Economist print edition

Another meaningless victory for the president of Belarus

AP

Braving the blizzards

CONSIDERING the fate that was promised for them—the president threatened to "wring their necks as one would a duckling" and the head of the KGB, as the Belarusian security service is still known, hinted that they might face the death penalty—the number of people who gathered at an opposition rally in a freezing Minsk square on March 19th was impressive. But a "colour" revolution this was not.

The protesters came to denounce the official results of that day's presidential election, in which Alyaksandr Lukashenka, Belarus's president since 1994, took 83% of the vote. Mr Lukashenka evidently wants bigger victories in each "election", which may be problematic if he stays for as long as he seems to want to. The official turnout was 93%, though polling stations in Minsk were thinly attended. By mid-afternoon, the one in which Mr Lukashenka himself voted was enlivened only by a group of Cossack musicians. Alyaksandr Milinkevic, the main opposition candidate, was given 6%. "This is not an election," he told the crowd. "This is an anti-constitutional coup."

The post-election choreography was familiar. Western observers criticised the mass arrests of opposition activists before the vote, the outrageously slanted media coverage, and so on. Monitors from most ex-Soviet states upheld the vote. Vladimir Putin, Russia's president, congratulated Mr Lukashenka; the Americans reviled him. At a bizarre press conference on March 20th, Mr Lukashenka triumphantly announced that western plots against him had failed. Revolutions, he said, happened only in weak countries. The protesters, he claimed, had been paid by foreigners. The West should be wary of antagonising him, he added, implying that he might let illegal immigrants or drugs slip into the European Union. As for democracy: was his press conference not democracy?

This week the EU was considering new sanctions on Belarus, but it is hard to see what either it or America can do. Mr Milinkevic faces a more pressing dilemma. Around 10,000 turned out on March 19th, but so did busloads of riot police in the side-streets, plain-clothed security thugs who mingled with the crowds, and a blizzard of such ferocity that some thought the KGB was responsible. Even so, more came, said Vladimir Ryzhkov, an independent Russian parliamentarian, than a Moscow rally would muster. But Mr Milinkevic could not claim that he had won the vote, as Viktor Yushchenko, now Ukraine's president, did in last winter's stand-off in Kiev. Mr Lukashenka's propaganda ensures that he is popular with many Belarusians.

Instead, the opposition called for a fresh election, which will not happen. By mid-week the urgent question was how long to stay in the square. The crowds had shrunk, although a few young people had brought tents along and camped out, Kiev-style, overnight. Since Ukraine's "orange revolution", a tent has become a threatening symbol to authoritarians such as Mr Lukashenka. The modest encampment in Minsk seems to have increased the risk of state-inflicted violence.

Yet so far Mr Lukashenka seems content to strangle rather than crush the protest. His thugs have tried to stop people bringing in food and warm clothes (since poles are too conspicuous, many flags were waved on retractable fishing rods). Dozens of people were arrested on the fringes of the square, including some opposition leaders. Mr Lukashenka may have realised that violence would be counter-productive; another theory has it that Mr Putin leant on him to exercise restraint. But Mr Lukashenka may also be waiting for the election observers and foreign press to leave before sending in the riot police. The campers hope to stay at least until this weekend, when Mr Milinkevic has called another big rally.

There is little point preaching democracy to a post-Soviet dinosaur like Mr Lukashenka. But like the dinosaurs, Mr Lukashenka's regime will expire—and this week's events may even hasten its demise. Plenty more Belarusians sympathise with the demonstrators than are willing to face the temperatures and truncheons on the square. "It doesn't make any sense to protest," said Katya, a pro-Milinkevic student outside a polling station. Next time, it might seem less pointless. "It began like this in Kiev," said Dmitro, a Ukrainian, waving his national flag. "In two years it will be over." Mr Lukashenka's end will come, even if not with the big bang the brave tent-dwellers wanted

this week.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

German state elections

The politics of shrinking

Mar 23rd 2006 | ASCHERSLEBEN
From The Economist print edition

The uncertain future of Saxony-Anhalt

DISSOLUTION is the right solution. That is an unusual platform for a politician who is hoping to win an election. Yet just such a radical proposal is central to the programme of Jens Bullerjahn, a Social Democrat running for the premiership of the eastern German state of Saxony-Anhalt after the election on March 26th. If he does well, other German politicians may copy his approach, as German states so clearly need to shrink.

“Promises are counterproductive. People clearly sense that something fundamental has changed,” says Mr Bullerjahn, standing in the old town square of Aschersleben, south of Magdeburg, the state capital. Bystanders do not seem to mind that the 43-year-old politician has doubts about the viability of their state. Other issues matter more: cuts in unemployment benefits, school closures, a dispute with the water utility.

Yet it would be understandable if voters wanted to preserve Saxony-Anhalt. Martin Luther was born there. No other German state has so many sites on UNESCO's world heritage list. Economically and demographically, however, the state is in dreadful shape. Since unification, employment has fallen by 21%. With jobs in short supply, the young are moving away, especially better-educated women. The population has fallen to 2.4m, from 2.9m in 1990.

Cobbled together after the second world war, Saxony-Anhalt has no real identity. Its first short legislative period after unification saw no fewer than three premiers, all Christian Democrats. Later, a Social Democrat-led minority government, tolerated by the ex-communists, coped little better with the collapse of the heavy chemical industry established by the former communist regime. “We were overly hopeful that the demographic problem would somehow go away,” comments Mr Bullerjahn.

When the Social Democrats lost the state election of 2002, the shock made Mr Bullerjahn realise that he and his party had to think afresh. He wrote a lengthy analysis of Saxony-Anhalt's future. His main conclusion: the shrinking of the state, which is inevitable, must be actively organised. This means focusing subsidies on promising regions rather than spreading them thinly. It also entails radically cutting the state's bureaucracy.

Yet even if Saxony-Anhalt does all these things, Mr Bullerjahn thinks it is unlikely to remain viable after generous federal subsidies run out in 2019. Ideally, it should merge with neighbouring Saxony and Thuringia to form a new state that he likes to call “Middle Germany”. Unsurprisingly, his political opponents are attacking this “doomsday scenario”, arguing that economic growth can still save Saxony-Anhalt. Wolfgang Böhmer, the state's Christian Democratic premier, has big plans to attract more investors. Wulf Gallert, of the Left Party, wants more state money for education and public-sector jobs. Yet even these two admit that it will be hard to turn things around.

The question is whether voters will value honesty, often a trademark of eastern German politicians. Last September, Angela Merkel, Germany's new chancellor, risked some candour, which almost cost her the federal election. Mr Bullerjahn's Social Democrats are unlikely to do much better than last time round. But he may end up as finance minister in a coalition with the Christian Democrats. He could even become premier if, against his declared intentions, he forms a coalition with the ex-communists. All bets are off, however, if the pollsters once again underestimate the strength of the neo-Nazis, who are running as a party called the German People's Union, or DVU. In 1998, this came out of nowhere, winning 12.9%, but it then disintegrated into bitter in-fighting.

Germany's political leaders should take note of Saxony-Anhalt—and not just those in the east. They may soon have to take a page from Mr Bullerjahn's unorthodox campaign. Things may be bad in this state, but they are little better in several others. Perhaps disillusion, not dissolution, is the answer, at least as a first step.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Italy

Sicilian vespers

Mar 23rd 2006 | PALERMO
From The Economist print edition

The election could be decided on the Mediterranean's biggest island

MANY Italians, particularly older ones, will vote in the election next month with a gloomy feeling that today's politicians do not match their forebears. Bernardo Provenzano, aged 73, of Corleone in Sicily, is no exception. But, as head of the Mafia, or *Cosa Nostra*, his reasoning is slightly different. Nino Giuffre, a *mafioso*-turned-informer who has testified to meeting the fugitive Mr Provenzano frequently, told a court last year that the boss of bosses often laments the "unreliability and inexperience of today's politicians, who are unable to take care of matters behind the scenes and favour our people."

One of the few for whom he has much time has been Sicily's governor, Salvatore Cuffaro, who is standing for parliament. Mr Guiffre said that he was regarded by Mr Provenzano with approval, as an "old-style politician". Although he is on trial for aiding and abetting the Mafia, Mr Cuffaro is the leading candidate in Sicily for the Union of Christian Democrats (UDC), the third-biggest party in Silvio Berlusconi's ruling coalition, and the one that has gained most ground in the five years since the centre-right came to power.

The legal case against Mr Cuffaro is shaky. He is accused of warning a *Cosa Nostra* boss that his conversations were being recorded by police. But prosecutors have produced evidence only to show that he told a friend and political associate, who in turn told the mobster. That said, the UDC in Sicily is enshrouded by what Italians term the "stench of Mafia". At least nine of its elected officials, including a junior minister in the government in Rome, are under investigation, on trial or appealing against their convictions in cases of alleged collaboration with *Cosa Nostra*.

As head of a regional government with much autonomy, Mr Cuffaro enjoys immense patronage. Such is his lust for control that he has even hijacked the appointment of local-government ombudsmen. Special commissioners have been assigned to 73 local authorities to decide who should scrutinise their performance. In Palermo, Lino Buscemi, the first choice of the left (and of many on the right), was brushed aside in favour of a UDC trusty. The special commissioner argued that, being a lawyer, the man would have more time to devote to his new duties.

The UDC's ability to drum up cash and hand out jobs was a big reason why Sicily swung so decisively behind Mr Berlusconi at the 2001 election. All 61 single-member constituencies in Sicily went to the centre-right. But that will not happen again. Ironically, this is because, at the insistence of the right (and particularly of the national UDC), all seats in parliament will be allocated by proportional representation. The new voting system could give rise to unpredictable results—even to the two chambers falling into different hands—but it will certainly stop a repetition of last time's Sicilian-style clean sweep.

Sicily matters, which is one reason why the Mafia's impact on Italian politics has been so great. Roughly one in every ten Italians is Sicilian, and the island will choose 60 of the 630 seats in the lower house next month. Few believe the right will be bested this time; but the left could easily snatch 20-25. That might be enough to decide the national outcome.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Turkey's cultural heritage

Topkapi capers

Mar 23rd 2006 | ISTANBUL
From The Economist print edition

The baleful consequences of cultural neglect

SOME time next month a panel of European arts connoisseurs will choose a city to be Europe's culture capital for 2010. Istanbul, capital both of the Byzantine empire and of its Ottoman conquerors, though not of modern Turkey, is a leading candidate. Egeman Bagis, who is spearheading the bid, reckons the title might double the 10m or so tourists a year who visit what claims to be the sexiest city in the world.

Yet perhaps the government should focus a bit less on title-chasing and a bit more on preserving the treasures that make Istanbul so intoxicating. At Topkapi, the museum overlooking the Bosporus that housed the Ottoman sultans until the 19th century, the situation is “disastrous”, complains the new director, Ilber Ortayli, who is a renowned Ottoman historian. The palaces are run rather like creaky government ministries in Ankara, stuffed with unqualified bureaucrats who “sit around doing nothing”. With shoestring budgets allocated by the government, they are falling into visible decay.

Parts of Topkapi are vulnerable to the earthquakes that often shake Istanbul. A group of Turkish and Italian experts recently said that, in the event of the “big one” that some seismologists expect to hit Istanbul in the next 20 years, Hagia Sophia, the 1,500-year-old Byzantine church, might collapse. Another worry is security. The culture minister, Atilla Koc, says that 18 artefacts were stolen from national museums and palaces over the past year alone. That may partly reflect a hiring freeze slapped on museums in keeping with IMF-inspired austerity measures. Security is now farmed out to private firms with little expertise, says Ozgen Acar, a journalist who traces Turkey's plundered wealth.

Yet the government's guards may be no better. Their ineptitude was evident at the Miletus museum, near Ephesus, last November. Armed robbers arrived in a tractor, bound and gagged the guards and put them in sarcophagi outside the museum. As they hauled off their loot they asked their victims if they could breathe. The guards nodded, and the thieves drove happily away.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Charlemagne

Back to school

Mar 23rd 2006
From The Economist print edition

Some remedial lessons are needed for European leaders

"TEACHERS, teachers, teachers." Thus the headmistress of a school near Helsinki, giving her not-exactly-rocket-science explanation for why Finland has the best education system in the world. This week, as European Union heads of government gather for their usual pointless spring summit to lament their lack of progress with economic reform—the so-called Lisbon agenda—they might remember this Finnish mantra.

The Lisbon agenda proclaimed that the EU should aim to become the world's "most competitive and dynamic knowledge-based economy by 2010". Obviously, the words competitive and dynamic are hilariously inapt at such a sluggish time, when most of France seems to have taken to the streets to defend the notion that one's first job should come with a lifetime guarantee. But the phrase "knowledge-based" is almost as incongruous.

Europe is failing its students. Seventeen of the top 20 universities in the world are American, according to Shanghai's Jiao Tong university. Over a quarter of students studying outside their country of birth are in America. Moreover, the EU's universities seem to be falling further behind—and not just behind America. Britain has almost doubled its graduate numbers since the 1960s, but that increase (which is rapid by EU standards) has been enough only to keep it in roughly the same position in the rankings of countries measured by graduates per head—in so far as numbers, rather than quality, can be a proxy for total educational output. Germany has increased its graduate population only slightly, and thereby plummeted from the middle of such rankings to near the bottom.

The fact is that global competition in higher education has become ferocious. South Korea has invested hugely in education and is now overtaking Europe in numbers of graduates (it has the third-highest number of graduates per head). China and India are producing more graduate engineers than the entire EU, which may be one reason why Microsoft has a huge research centre in Beijing (though it also has more than one in Europe).

The blunt fact is that most Europeans do not value degrees as highly as Asians or Americans appear to. In a new study for the Lisbon Council, a Brussels pressure-group, Andreas Schleicher offers some calculations that try to estimate what degrees are worth to university graduates. Everybody does well: on average, a student gets a 10% return on his (or more often his taxpayers') investment. But in America the average return is around 15%; in France and Italy it is only 8%.

Europe's failings in higher education are familiar enough. More surprisingly, it is falling behind in secondary schools as well. The performance in mathematics of an average 15-year-old from a big European country is at or below the international average, according to the PISA study run by the OECD. Top of the list are Hong Kong, South Korea and Japan, plus a few small outward-looking EU members (including Finland).

Worse still, European schools do not provide the equality of educational opportunity that people seem to think they

do. The PISA study also tries to assess how much student performance is affected by socio-economic background and how much by personal skills, by considering variations in mathematics results both within and between schools. The first variation presumably reflects student skill; the second, the socio-economic background of schools and students. If EU countries had equitable education systems, one might expect a lot of variation within schools, because pupils vary, but rather less between schools.

In fact, one finds precisely the opposite. The differences between schools are larger in most big EU countries than in the United States, for all its supposed canyon between hyper-achieving magnet schools and dismal sinkholes. Only a few small EU countries actually deliver an equitable education; and these are the ones that have junked the devices, such as stringent national curricula, or central direction from state or national bureaucracies, that are supposed to ensure equal education.

To the Finland Station

The explanation, argues Mr Schleicher, is that European education is stuck with an industrial mindset and has not adapted to the post-industrial world. Post-industrial organisations insist that innovation must come from anywhere; that hierarchies must be flat; and that everyone should be well educated. Manufacturing required a pyramid: lots of unskilled manual workers, some skilled ones, plus a few highly educated managers. The schools that meet this old demand—with early selection of students into academic and vocational streams, elite academic colleges and good vocational training—are still around, especially in Germany and central Europe. They are testimony to Europe's resistance to change. (How many teachers does it take to change a lightbulb? What do you mean, *change*?)

Looking at France today, one might despair that change will ever come. Its government even blocked the publication of findings on French educational achievement and incomes (in a spirit of friendly co-operation, we have done some back-of-the-envelope calculations which suggest that standards in French schools are more closely related to incomes than in other countries). Yet in the 1960s, Finland had all these faults. Now, it has the best schools in the world. Finnish 15-year-olds have the highest level of mathematical skills, scientific knowledge and reading literacy of any rich industrialised country.

It has achieved all this by changing its entire system, delegating responsibility to teachers and giving them lots of support. There is no streaming and no selection; no magnet schools; no national curriculum; and few national exams. It is all, as that Finnish headmistress suggested, about getting good teachers—and then giving them freedom. If there is a lesson for EU leaders, it is: forget about multiple priority areas and action plans. European governments should go back to school. In Finland.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The budget

Head to head

Mar 23rd 2006
From The Economist print edition

Mr Brown's budget was about politics rather than economics

Getty Images

Get article background

AS BUDGETS go, Gordon Brown's tenth was a dreary affair. It was as short in substantive changes to the public finances as the chancellor of the exchequer's speech was long. Taken together, Mr Brown's measures give away a smidgen in the fiscal year beginning next month and raise a bit less than £500m ($890m) in 2007-08, small change for a government that will rake in revenues of over £550 billion that year.

The chancellor craftily got his nasty surprises out of the way in the pre-budget report last December, when he downgraded his growth forecasts and revised upward his borrowing projections. As a result, he was spared any blushes on March 22nd. Mr Brown left his GDP growth forecasts for the next three years unchanged. And he had to make only a small upward revision to his projected borrowing in 2006-07.

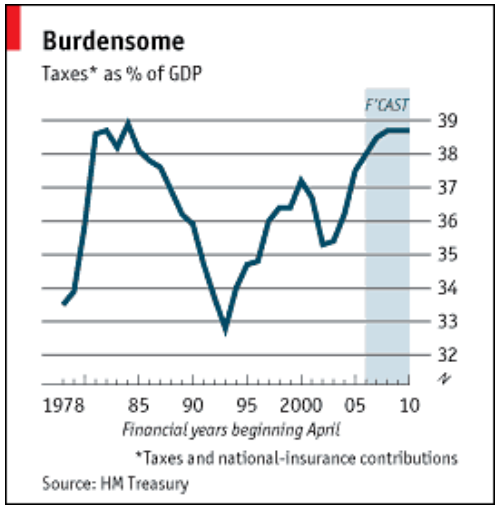
But if the budget failed to raise sparks as an economic set-piece, it was anything but boring as a political event. It offered a first glimpse of the political battle to come when Tony Blair eventually steps down as prime minister. That will almost certainly pitch Mr Brown against David Cameron, the new Conservative leader. Judging by his speech this week, Labour's next prime minister will take a very different approach from the one Mr Blair has adopted.

Mr Cameron has developed a line in flattering Mr Blair that is intended to distance the prime minister from his party, but which sometimes has the effect of distancing the Tory leader from his. For his part, Mr Blair, safe in the knowledge that he has fought his last general election and inclined to see himself as a national leader almost above party, is happy to go along with it. He is, he says, always pleased when people agree with him.

That is not Mr Brown's way. If he becomes prime minister, he is no more likely to abandon the centre ground of British politics than Mr Blair. But he is determined to mark the territory with his own distinctive scent, one that nobody is likely to confuse with Mr Cameron's. For Mr Brown, politics is all about showing how and why you differ from your enemies. And in Mr Cameron's oft-repeated, rather reasonable-sounding mantra that a Tory government would share the proceeds of growth between increasing spending and cutting taxes, Mr Brown sees his opportunity.

In a key passage of his budget speech, Mr Brown denied this proposition. Rather than “dogmatically imposing a third fiscal rule”—to add to the two he himself has set for public borrowing and debt—he would exercise his judgment in each budget to make the right choices in using the nation's resources. Crucially, he insisted that he would “look

at the merits of the case to get the balance right between tax, spending and borrowing and in doing so it is also right to consider the case for additional investment in the national interest."



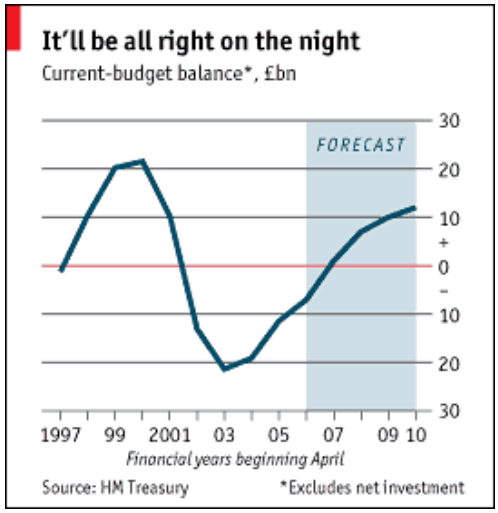
It is perhaps not surprising that a politician as supremely confident as Mr Brown believes that the national interest is better served by his spending more money than by allowing hard-pressed taxpayers to keep a little more of their earnings. But it is unusual to hear the claim made with such hubristic certainty. Apart from shelling out some money to help British athletes run faster and jump higher at the London Olympics in 2012, the particular bit of the national interest that the chancellor has identified as being worthy of his support seems to be education.

If there was a big idea in Mr Brown's tenth budget, it was that he intends to bridge the gap between the £5,000 a year spent per pupil in state schools and the £8,000 a year spent on average in private schools. Mr Brown said that he could afford to use the £440m extra he had put aside for education to cut taxes, while remaining (just) within his fiscal rules. Investing in education, however, was this budget's considered choice.

Mr Brown, it seems, sees this as a goal similar to the one that Mr Blair set for his government in 2000 when he promised that Labour would raise spending on health until it matched the European average. Interestingly, the deficit-ridden National Health Service, the recipient of so much largesse from Mr Brown, got hardly a mention in the chancellor's hour-long overflight of the British state.

Responding to a budget speech is one of the more difficult tasks faced by any leader of the opposition. Mr Cameron rose to the occasion with some style and wit, but he was at his most effective when accusing Mr Brown of having squandered money on unreformed public services: "Billions raised. Billions spent. No idea where the money's gone. With a record like that, the chancellor should be running for treasurer of the Labour Party."

Mr Cameron's jokes were better and more plentiful than the chancellor's, but Mr Brown has laid down a challenge to the Tory leader that is only partially answered by repeating the charge of government profligacy. In effect, Mr Brown has signalled that when he becomes prime minister he will lavish billions more on schools, while clamping down tightly on other departments' spending. Mr Cameron will have difficulty matching that pledge while hanging on to any hope of lower taxes in the future. That is a dividing line of Mr Brown's choosing and one that he believes can win him the next election.



The chancellor thus chose to use his budget to set out what will distinguish him from Mr Cameron rather than to sort out the public finances. The strategy is fraught with risk. The budget numbers may not have changed that much from last December, but a lot has to go right for them to be correct. Mr Brown's forecasts for growth in 2007 and 2008 are optimistic (see article). And the Treasury's view that there is a lot of headroom in the economy is not widely shared. The IMF recently said there was only "a small degree of excess capacity".

Mr Brown's insistence on spending more rather than taxing less could backfire if growth disappoints and borrowing stays too high. Then he might come to regret putting politics before economics.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Political parties

Going, going, gong

Mar 23rd 2006
From The Economist print edition

The funding scandal gets messier

EVER since Jack Dromey, the Labour Party's treasurer, announced last week that he did not know who had been bankrolling his party for the past year, the government has been running around like a defrocked priest in search of a surplice. Labour has since said that it has been kept afloat by £14m ($25m) of loans from undisclosed supporters. Four of them were also nominated by the party for seats in the House of Lords.

This is not illegal, but it doesn't look good. Under current law, while donations of £5,000 or more must be reported, loans bearing a commercial rate of interest need not be. Labour came to power in 1997 promising to fund itself transparently (unlike that sleazy Tory party) and said peerages and other honours would not be for sale. Since then, according to the Power inquiry, a task-force set up to ponder the state of British democracy, every donor who has given £1m or more to the Labour Party has ended up with a gong. Rod Aldridge, who lent Labour £1m, also ran Capita, a company that has secured several big government contracts. Mr Aldridge resigned from the firm on March 23rd.

The threat to Labour's saintly aura prompted it to take swift action. Tony Blair asked Sir Hayden Phillips, a former civil servant, to come up with proposals to clean up political party funding. Then on March 20th, Lord Falconer, the minister in charge of constitutional affairs, proposed to make parties name creditors in future. The party outed those it already had in tow. The following day, Labour's National Executive Committee rallied round Tony Blair but said it would take the funding reins back into its own hands.

The Conservatives at first kept their heads down, and with good reason. The party has raised a rumoured £20m in loans from undisclosed well-wishers and has not yet revealed their names. On March 20th, however, David Cameron, the Tory leader, put forward his own party's reform plans, including a £50,000 cap on donations, measures to encourage smaller gifts and a reduction in election spending.

Labour's misery increased when Scotland Yard said it would investigate, at the request of some mischievous Scottish and Welsh nationalist politicians, whether the party had traded loans for peerages. Worse, some of Labour's backers are now saying they want their loans paid back. That would pitch the party into real financial trouble. One proposal to raise cash is to sell the lease on the party's old headquarters around the corner from Parliament. That would be a fitting symbol of the fix the parties are in (the Liberal Democrats have also had their funding problems).

Britain is not alone in struggling to find the best way to pay for politics. In most rich democracies (including Britain), the state plays some role in bankrolling parties. But the proportions of private and public support vary widely.

In systems where parties or candidates depend largely on private money, politicians risk becoming beholden to special interests. Where such support is limited by law, money has a way of finding its way over the wall. In America, a ban on giving “soft” money to parties was followed by the mushrooming of “527” organisations (named after a clause in the tax code) that spend money to influence voters.

The alternative is to make taxpayers provide a bigger share of party budgets, as they do in countries including France, Sweden, Germany and Japan. But state funding carries risks: it can prop up failing franchises, prevent new parties from emerging and increase the distance between party supporters and political elites.

Proper funding formulae can mitigate these risks, and after this week it looks as if Britain will head in the direction of more state funding. Faced with the prospect of paying for a barrage of red, blue and yellow mailshots every four years, voters may decide a little sleaze wasn't so bad.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

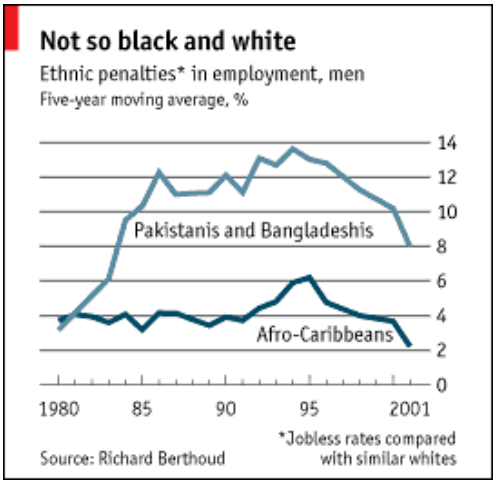
Inequality

Closing gaps

Mar 23rd 2006
From The Economist print edition

An investigation into unfairness turns up the opposite

IT WASN'T supposed to work out like this. A year ago, the British government asked a team of worthies to produce a kind of inequality audit. The group, led by Trevor Phillips, chairman of the Commission for Racial Equality, was expected to report on the persistence of old forms of discrimination as well as sniffing out new ones. On March 20th, it released a preliminary report. The shocking finding: Britain is becoming fairer.



The news was especially good for two much fretted-over groups. Afro-Caribbean men (who rioted in the 1980s) and Pakistani and Bangladeshi men (who presently worry the security services) are now much more likely to be in work or studying for a degree than they were before. Research carried out by Richard Berthoud of Essex University shows that, after controlling for things such as qualifications and the strength of the local job market, both groups have steadily closed the employment gap with whites since the mid-1990s (see chart). The disabled seem to be faring slightly better, too.

Why? The long period of economic growth that began in 1992 surely helped, but it cannot be the only explanation. Caribbean men did not close the employment gap with whites during the 1980s boom, and Pakistani and Bangladeshi men actually fell further behind.

One difference, says Mr Phillips, is that the previous economic boom sucked in a reserve army of women workers. They are now entrenched in the labour market, so to fill new jobs employers must turn to the sort of men who were traditionally passed over for work—many of whom are black or brown-skinned. It helps, too, that much of the job growth in the past few years has been in the public sector (see article). Hiring policies there are colour-blind to a fault, as a casual visit to any British hospital will confirm.

The expansion of higher education has evened things out, too. The number of Britons studying at university has increased by a third since 1995, with students from ethnic minorities almost doubling in the same period. Black and Asian graduates are still less likely to be employed than white graduates, but the gap is narrower than it is for the unskilled.

One blot on this otherwise happy picture is that Pakistani and Bangladeshi men are still concentrated in a few jobs. One in nine Pakistani men drives a taxi; one in three Bangladeshi men is either a cook or a waiter. A downturn in the "Indian" restaurant trade where so many of the latter work would be catastrophic.

At least that threat lies in the future. A bigger present problem turned up by the equalities commission has to do with a group that has not, until recently, attracted much attention, and does not suffer the kind of overt discrimination that race warriors tend to worry about. Just a quarter of Pakistani and Bangladeshi women are in work or studying; according to Mr Berthoud, they are 30% less likely to have jobs than other women, even after taking account of the fact that they are less qualified and more likely to have children. This gap is closing, too, but painfully slowly.

Tasneem Miah, who works with Bangladeshi women in London, says young Asian Muslims are much more ambitious than their parents. They are less likely to marry in their teens and more inclined to pursue a career. But their prospects are still shaky. Some husbands (and some mothers-in-law) recognise the value of a second income. Others believe that traditional prohibitions on women working outside the home outweigh the extra money they could earn. Which way the balance tips will have a great effect on their prospects, together with those of the ethnic groups to which they belong.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Gordon Brown and the economy

Lustre lost

Mar 23rd 2006
From The Economist print edition

After an exceptional decade, the economic prospects look less bright

Get article background

SINCE emerging from the recession of the early 1990s, Britain has thrived. An economy that used to suffer from wild swings in inflation and growth has become “a paragon of stability” according to the OECD. Between 1995 and 2004, the growth in GDP per person was both stronger and less variable than that of other rich countries in the G7, according to the IMF.

Currency dealers—sterner judges than international economic organisations since money is at stake—have also reached a favourable verdict. The pound has ridden high in the past decade, too high at times for comfort. The spectre of sterling crises that haunted Britain for so long after the second world war—from the devaluation in 1949 to “Black Wednesday” in 1992—has become a receding memory.

Gone, too, is the shame of Britain's relative economic decline compared with the rest of Europe that caused such alarm and despondency for a generation of post-war politicians. Steady growth at home, together with woeful underperformance across the Channel, has enabled Britain to overtake France, Germany and Italy in prosperity, measured as GDP per person.

Britain's labour market was once notoriously dysfunctional—encapsulated in the 1959 film “I'm All Right, Jack”—because of overweening union power. But over the past decade it has been a reformed character. Employment has risen by 3.5m, an increase of almost 15%, since early 1993. The jobless rate has fallen over that period from 10.5% of the labour force to 5% without triggering a pay explosion.

For most of the economy's long and uninterrupted expansion, Labour has been in office. Gordon Brown, the chancellor of the exchequer, who presented his tenth budget on March 22nd, likes to cast himself as the man who has made it all happen. The public applauded him at the polls last year: his success in managing the economy was an essential element in Labour's third consecutive general-election victory.

In fact, the turning point in Britain's economic fortunes occurred not in May 1997, when Mr Brown took office, but in September 1992, when the pound was slung out of the European exchange-rate mechanism. After the debacle of that episode, the Conservative government adopted a policy of inflation-targeting. It had already begun to prove its worth before Labour won power. As important, Margaret Thatcher's unpopular reforms in the 1980s to curtail union power and make the labour market more flexible were paying off by the mid-1990s.

Mr Brown's main achievement when he took office was not to mess up the regenerated economy that he inherited. In particular, he deserves to take a bow for his first, best and boldest reform. The decision in May 1997 to make the Bank of England independent in setting interest rates has entrenched and improved the new inflation-targeting regime. The bank has adroitly guided the economy over the past nine years, succeeding beyond initial expectations in keeping inflation close to the target rate—currently 2% a year for consumer prices—set by the chancellor.

Too good to last

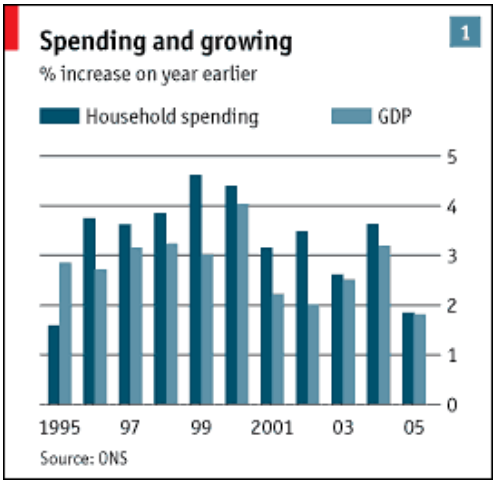
But over the past year or so things have started to go amiss. The economy's formidable performance faltered as GDP growth decelerated from 3.2% in 2004 to 1.8% in 2005, the lowest since 1992. Unlike the slowdown in 2002, which could be blamed on a sharp downturn in world trade after the dotcom crash, the setback in 2005 was mainly home-grown, occurring at a time when the world economy was swinging upward.

The economic reverse has cast a lengthening shadow over the labour market. In the year to February, the number claiming unemployment benefit has risen by 102,000. Last month's increase in the claimant total of 14,600 was the biggest since December 1992, when the economy was clambering out of recession.

Mr Brown puts a brave face on the setback. The chancellor argues that the economy has been hit by two shocks, the jump in oil prices and a slowing housing market. In the past these would have been knock-out blows causing

recession but on this occasion they have merely winded the economy. Such resilience should enable growth to pick up over the next three years. In his budget, Mr Brown forecasts that GDP will increase this year by around 2.25%—below the post-war trend rate of 2.5%—but then bounce back to above-trend rates of around 3.0% a year in 2007 and 2008.

But this happy scenario will be realised only if the economy's exceptional performance during the past decade proves no longer to be exceptional. Has it become the new norm? Two significant improvements are indeed structural. First, low inflation has become ingrained in people's expectations. This both makes it easier for the Bank of England to steer the economy and helps businesses as they plan and invest for the future.



Second, despite too many burdensome new regulations on employers under the Labour government, Britain's labour market has not returned to the bad old days. Unions, which have continued to haemorrhage members outside the public sector, are a waning force in the private economy, unable to call the shots in pay bargaining. Both these structural changes have helped to keep the recent surge in oil prices from generating a wage-price spiral, which made the earlier oil-price shocks in the mid-1970s and early 1980s so damaging.

Despite these genuine gains, the expansion over the past ten years has not been as securely grounded as Mr Brown would have us believe. The exceptional decade has been exceptional in other less virtuous ways. Three distortions have developed in the pattern of demand, which will cause economic pain as they are corrected.

First and most important, the consumer has never had it so good for so long (see chart 1). Since 1995 consumer spending has increased by 3.5% a year, well ahead of the economy, which has itself expanded at an above-trend annual rate of 2.8%. Growth in household consumption has outstripped that of GDP for ten years. That includes 2005, albeit by a slim margin. The sustained strength of consumer spending is unsurpassed in post-war history. It has lasted much longer than the consumer boom of the 1980s and it also puts the 1950s in the shade.

Second, another sustained surge, this time in government spending, is also breaking long-distance track records (see chart 2). Since 1999, real government expenditure has risen at an average rate of 4.9% a year, well ahead of GDP growth over the same period. Although public-spending growth is now decelerating, it will still outstrip the economy's expansion in 2006-07, the fiscal year starting in April.

Third, Britain's external trading position in goods and services has got worse and worse (see chart 3). Net trade—exports less imports—last contributed to GDP growth in 1995. Since then it has been a drag on growth for a record ten years as the trade balance has moved heavily into deficit.

The party's over

None of these trends can continue. Since household spending accounts for over 60% of GDP, the prospects for the consumer are crucial. The main reason why consumption growth has outstripped GDP growth is that people have been saving less. Between 1995 and 2004, the household saving ratio fell from 10% of post-tax income to 4.4%. That decline has been made possible by an ebullient housing market: between mid-1996 and mid-2004, house prices rose by over 180%. With that windfall, homeowners felt richer and spent more than they earned.

The foundations of the long consumer boom were thus undermined when the housing market abruptly slowed in the second half of 2004. On cue, consumption growth slowed from 3.6% in 2004 to 1.9% in 2005, the lowest increase since 1995, when the housing market was still depressed after the crash at the start of the 1990s.

On this occasion, national house prices have stagnated. Indeed, there have been recent stirrings of recovery, with a rise in home-purchase mortgage approvals and an uptick in prices. But this is likely to prove a false dawn while prices remain so very high in relation to rents or income. The OECD estimated at the end of last year that British property was among the most overvalued in the rich world.

In any case, there are other forces bearing down on consumers. Since 2000, household debt has jumped from 110% of disposable income to 150%. With so much more principal to repay, debt servicing now gobbles up a much bigger portion of household budgets even when interest rates are quite low.

Already, the household saving ratio has jumped from 4.1% of disposable income in the final quarter of 2004 to 5.5% in the autumn of 2005. Yet it still remains below its historical average of 8%. Worries about pensions and growing feelings of insecurity about jobs are further reasons to expect a rise.

Even if the saving ratio does not increase further, there are two other powerful curbs on consumers. First, higher energy prices are, in effect, a tax on household budgets. Second, a tax grab by Mr Brown has been holding back the growth of real disposable income, which averaged less than 1% a year for typical households in the two fiscal years ending March 2005, according to the Institute for Fiscal Studies. The squeeze is likely to persist, since a further rise of almost one percentage point in income tax and national insurance as a share of GDP by 2010-11 is forecast in this week's budget.

Turning off the tap

All this suggests that growth in consumption will be subdued for some years to come. At the same time, the support from government spending, which was especially important in blunting the blow of the dotcom downturn, will also be waning. Over the next two fiscal years, growth in spending will slow to around 3% a year, quite a healthy rate in usual times but sharply down from the 4.9% rate over the past six years. From April 2008, it will be clipped back still further. Mr Brown has pencilled in tough plans for spending to grow by only 1.9% a year—below trend GDP growth—in the three years to 2010-11.

In short, the era of big spending is ending for the government as well as for consumers. If GDP growth is to be sustained, it will have to rely on other sources. Business investment, which has been disappointingly weak over the past five years, will need to pick up. So, too, must net trade, in a further correction to the distortions of the past ten years.

The trouble is that this necessary shift in the composition of demand is likely to slow GDP growth over the next few years. Flush with cash, firms should be stepping up their capital spending. However, the need to deal with big pension-fund deficits is holding back business investment. In a self-reinforcing process, firms are less likely to invest if they think that the economy's growth prospects have got worse.

The outlook for exports is also less promising than it should be. Britain does well in exporting services. It compares favourably with other big European economies in the technological intensity of its goods exports, according to the Swiss Institute for Business Cycle Research. That's a big plus, since high-tech trade is growing especially fast. Yet given these advantages, the record of exporters—with a steady decline in Britain's market share—has been disappointing. Exports suffered in the late 1990s because of the strong pound and in the early 2000s when world trade turned down. More troubling, they have failed to benefit as much as they might have from the subsequent global upswing.

If the supply side of the economy were in better shape, a slowdown in demand growth would be only temporary. But there are reasons to believe that the underlying growth of capacity has also fallen off.

For one favourable supply-side development, look at the workforce. Britain has seen a surge in immigration since it opened its borders to workers from new member states of the European Union. Between May 2004 and December 2005, 330,000 migrants from eastern Europe registered for work. The demographic shock from the rise in the working-age population could raise GDP growth by 0.1 percentage points a year between 2007 and 2009, according to the National Institute of Economic and Social Research.

The trouble is that this demographic boost to growth is likely to be outweighed by the impact of higher oil prices. According to the IMF, the doubling of energy prices between the end of 2003 and the end of 2005 will cause a cumulative output loss of about 1%, spread over the three years to 2008. That would lower annual GDP growth over this period by an average 0.3 percentage points.

Efficiency slowdown

Recent figures for productivity—the fundamental impetus behind capacity growth—are also discouraging. Output per hour worked failed to increase at all in the year to the third quarter of 2005. The economic cycle accounts for much of this dismal performance: productivity growth generally falls during a downturn. But there also seems to be structural deterioration. Over the past four years, productivity has risen by 1.7% a year, well below the average 2.1% achieved from early 1992 to late 2005.

This slowdown is a personal setback for Mr Brown, who has made much of his efforts to improve productivity through measures such as a beefed-up competition regime and tax incentives to stimulate more corporate R&D. The chancellor is in fact part of the problem. Business investment—an important source of labour productivity growth—has been weak in part because of the regulatory and tax burdens that he has heaped on companies. Mr Brown has also increased spending in the inefficient public sector. Productivity in the National Health Service, for example, declined from 1999 to 2004 by between 0.9% and 1.5% a year, based on figures in the national accounts.

A recent survey of the British economy by the OECD highlighted weaknesses that hold back productivity. Persistent deficiencies in education mean that the workforce in Britain includes a much bigger share of low-skilled people than in most other rich countries. Decades of under-investment in transport have caused congestion and delays. And Britain compares poorly with the best-performing countries in innovation, which is especially important nowadays in securing productivity advances among rich countries.

This litany of complaints sounds drearily familiar. The exceptional decade has not transformed the economy, although it has helped it to work rather better than in the past. Mr Brown's reversion to tax-and-spend, together with the ever-rising burden of regulation, is starting to do increasing damage to work incentives and business interests. The price for past excess, both by consumers and by the chancellor, will be future slower growth. As the feel-good factor fades, the politics of plenty will give way to the politics of austerity.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Christian activists

Linking souls across the sea

Mar 23rd 2006
From The Economist print edition

British Christians are cautiously using American-style political muscle

OVER the next few weeks, virtually all Catholic worshippers in England and Wales will be given leaflets or DVDs urging them to lobby Parliament against a bill that would allow doctors to assist in suicide. The Evangelical Alliance, which claims to speak for a million voters of a broadly low-church variety, speaks out almost daily on public issues ranging from gambling to gay rights. The number of Christian charities, whose concerns include support for the traditional family, is burgeoning. And in last year's election, Christian groups showed a new sophistication: as part of their efforts to "make the cross count", they sent candidates questionnaires on ethical issues and used telephone hotlines to publicise the result.

Could this mean that, even as their faith loses its old status at the heart of Britain's establishment, Christian groups are regaining political muscle—by learning tricks from their counterparts across the Atlantic? Among secular-minded Britons, there are already fears that an American-style religious lobby could gain an influence out of all proportion to its numbers.

It is certainly true that for every variety of British Christian, from liberal Anglican highbrows to ultra-Protestant tub-thumpers, the wealth and organisational strength of their American cousins is tantalising. "British Christians think the grass on the other side of the Atlantic is greener, and they are partly right," says Grace Davie, a sociologist of religion.

But in fact, says Mrs Davie, fears—or hopes—of an ever-growing religious lobby are exaggerated, and that is not simply because Britain is a less pious place than the United States. (Barely 7% of Britons attend worship on an average Sunday, compared with 40% of Americans.) Even Britons who call themselves Christians often dislike the notion of religious leaders getting heavily involved in politics. When Christian lobbies are effective, it is by making coalitions with others—and then staying in the background.

The campaign against doctor-assisted suicide is a case in point. Its most vocal constituents are groups representing doctors, carers and the disabled—and they rest their case on professional expertise, not religious rules. With some exceptions, church leaders have avoided taking centre stage. As one Catholic insider puts it, "You don't want people to say, 'those religious types would think that, wouldn't they?'"

One recent victory for low-church Christians was the watering-down of a bill, demanded by Muslims, that penalises the stirring up of religious hatred. On that question, the Evangelical Alliance, defending its right to proselytise, teamed up with anti-religious humanists and comics. But more recently, the humanists have been at loggerheads with Christians of all stripes over state support for religious schools.

While British Christians often draw on the resources of their richer American cousins—in the form of books, taped sermons, radio material and so on—some of the strongest transatlantic ties are not between conservatives; they are between the (relative) "religious left" in both countries.

"God's Politics", a best-selling American manual of evangelical Christianity with a leftish tinge, won high praise during its recent British launch—in particular from Gordon Brown, a chancellor with Scottish Presbyterian roots. Its author, Jim Wallis, returned the compliment by hailing Mr Brown's record on third-world debt.

But not all religious influence flows eastwards. It was a visit to Britain that prompted one of America's top evangelicals, Richard Cizik, to launch a campaign on global warming. "I had a conversion experience on the climate issue not unlike my conversion to Christ," he reported, after hearing Sir John Houghton, a leading British scientist, warn of melting ice-caps. And Mr Cizik sees no contradiction between his new cause and the older conservative agenda: "We see care for the creation as another sanctity-of-life issue."

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Teaching reading

Fast, first—effective?

Mar 23rd 2006
From The Economist print edition

The government's latest approach to literacy is riling teachers

WOODBERRY DOWN is a community school in one of London's most deprived boroughs, Hackney. One-quarter of its children are asylum-seekers, many of whom speak no English when they arrive. Almost two-thirds are so poor that they are on free school meals.

In this unpromising soil, the seeds of synthetic phonics—a back-to-basics way to teach children to read by breaking down the 44 sounds that make up English words—are bearing fruit. Four years ago, the school embarked on a concentrated phonics scheme. Emma Penzer, the deputy head, says that it has already raised reading standards. In 2003, only 69% of children tested at Key Stage 1 (ie, at about seven years old) read at the expected level. Last year the rate was 87%, two points above the national average.

That is the sort of success that Ruth Kelly, the education secretary, would like to replicate elsewhere. This week she endorsed a report recommending that synthetic phonics be the “prime” approach by which young children are taught the building blocks of reading. Its author, Jim Rose, a former director of the school-inspections body, Ofsted, says that phonics should be taught “fast and first”. So, from September, primary school teachers across England will devote part of each day to sounding out “d-r-ea-m” with their classes.

Despite recent improvements, one in five 11-year-olds leaves primary school unable to read and write adequately, so something needs to improve. What won Westminster's ear for synthetic phonics was essentially a seven-year experiment in Clackmannanshire in Scotland. By the age of 11, children taught to read there through synthetic phonics are three and a half years ahead of their peers taught by other methods. Some reckon that boys, in particular, do better with a system like this that offers hands-on tools. So might children whose first language is not English.

On phonics as on secondary school reform, New Labour and David Cameron's new Tories seem to think alike. It was Nick Gibb, the shadow schools minister, who persuaded the all-party education select committee of the House of Commons to examine reading standards last year. The committee then recommended that synthetic phonics should be examined in greater detail. David Cameron, as shadow education secretary, praised synthetic phonics almost a year ago.

Indeed, few do not. But relying on this sort of phonics to the virtual exclusion of everything else is contentious. The approach was popular in the 1960s, when grammar schools were too, but then fell from favour. Since 1998 teachers have been free to choose from various strategies.

Some argue that children learn to read best by recognising whole words. Others like “analytic phonics”, which breaks words into components that are larger than single sounds (as in “dr-eam”). Spokesmen for teachers' unions insist that different children respond to different methods, and that teachers should be trusted to make the call.

Evidence that synthetic phonics is categorically better than analytic phonics is in fact inconclusive, according to a government-funded study released two months ago. “Synthetic phonics does look promising,” says Carole Torgerson of York University, one of the report's authors. “We found it had a moderate effect compared with whole-language approaches, but the evidence base for this conclusion was 12 relatively small trials, only one of which was UK-based. This would be an ideal time to do a national evaluation by implementing systematic synthetic phonics in some schools and not in others and then comparing the two.”

That Ms Kelly plans instead to embed synthetic phonics into the national curriculum so quickly worries even one of the system's most ardent fans. “I welcome the report,” says Ruth Miskin, a well-known former head teacher and author of a popular phonics programme, the one that Woodberry Down uses. “But I worry about what the Department for Education and Skills will do with it. It has brought out five different reading systems since 1997 and yet many children are still failing to read. You have to trial a system for years to make sure it is going to be effective.”

While the debate rages, some schools are quietly getting on with it. Critics say that so mechanically prescriptive a system can bore students. Yet Year One at Woodberry Down are entranced by their phonics lesson. As their

teacher, Nathalie Marshall, holds up cards with single letters or sounds, the children shout each one out, then a rhyme to fix it in their memories. Miss Marshall admits that she was sceptical, but says she has been won over. “These children are average in ability, but in reading they are above average already.” Time will tell if others do as well.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The Royal Shakespeare Company

Going east

Mar 23rd 2006
From The Economist print edition

A troubled theatre company looks to Moscow for inspiration

MEASURED against the lifespan of the average firm, the Royal Shakespeare Company verges on the venerable. Based in Shakespeare's birthplace in Stratford-upon-Avon, the RSC has operated as a finishing school for British acting and directing talent since it was founded in 1960.

Lately it has run into trouble. Its most recent crisis started when the RSC lost its secondary home in London in 2002 and ran up a deficit of £2.8m, despite a regular subsidy from the Arts Council, a government body. Plans to rescue the company included knocking down the main theatre in Stratford and building a "Shakespeare village" on the rubble. That idea was ditched. Next month a less drastic but equally ambitious new plan for the RSC will begin: the company is staging all 38 of Shakespeare's plays in a single season.

"All arts organisations totter along on a pair of fairly high heels," says Vikki Heywood, the RSC's executive director. Thanks to a period of retrenchment, though, the company's financial health is currently good. The operating deficit has gone and the RSC reckons it has saved enough to subsidise "Timon of Athens" and some other canonical loss-leaders.

If the season succeeds—and, with the help of well-known actors such as Judi Dench, it may well do—it will vindicate a new management team that took over in 2003 and advertise a style of theatre that is largely foreign to Britain and America. If it flops, the RSC will be in trouble again.

When Sir Peter Hall founded the RSC, he drew inspiration from European theatre groups, in particular Bertholt Brecht's Berliner Ensemble. This style of theatre puts a premium on keeping the same group of actors together for a long time under a strong director, rather than casting a few stars in lead roles and allowing them to shine, as English-speaking theatres tend to do.

Michael Boyd, the RSC's artistic director, wants to get back to the ensemble approach to putting on plays. Mr Boyd trained in Moscow and admires the company-first approach of much eastern European theatre. Some of the RSC's current crop of actors will spend five years with the company, and Mr Boyd wants resident writers to work with them on new plays.

This aim is laudable, but three things will make it hard to carry out. First, luring talented actors to Stratford to live in a bedsit on a pittance is hard, even for one season. Many regard a spell at the RSC as a bit like a master's degree from a good university: something to complete as quickly as possible, put on the CV and use to get a job that is better paid. Also, Britons like their stars—as the return of Dame Judi and some other big names attests.

Second, there are lots of non-RSC Shakespeare productions competing for audiences. In London alone, Shakespeare plays are often performed at the National Theatre, the Globe and (when RSC plays transfer to London) in the West End. The unsubsidised Globe, with its Elizabethan and Jacobean costumes (and £7 standing seats), poses a challenge to the RSC. "All competition is good," argues Ms Heywood, who thinks that supply of the Bard creates its own demand. But theatre-goers do not have to travel to the RSC's Stratford base to see good Shakespeare—one reason why the RSC chases around London looking for a venue there.

The third problem is that Shakespeare was just born in the wrong place. Innovative companies need big, loyal audiences, particularly when they have around 2,000 seats to fill, as the RSC does in its three Stratford theatres. "We like to think of Stratford as being like Salzburg or Bayreuth," says Stanley Wells, a Shakespeare scholar who now runs the Shakespeare Birthplace Trust in Stratford. "But in some ways it's really a little provincial town."

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Bagehot

A broken system

Mar 23rd 2006
From The Economist print edition

Tony Blair deserves blame and some sympathy over the loans-for-peerages scandal

THIS week, Tony Blair made a thoughtful and challenging speech on how to confront and defeat Islamist terrorism. Nobody was listening. Last week, he made a thoughtful and challenging speech explaining why there was no alternative to making public services more responsive to the needs of the people who use them. Nobody listened to that either.

It would be difficult to think of two more important subjects. But for ten days, the only headlines the prime minister has generated have been to do with his role in raising large undisclosed loans for Labour's election war-chest from rich donors, some of whom were subsequently recommended for peerages.

Mr Blair's part in this gruesome mess is indefensible. The responsibility for seeking and accepting the loans, totalling about £14m ($25m), was his alone. The decision to conceal the identities of the lenders, which Mr Blair at least acquiesced in, breached the first rule of public life: anything concerning the nexus between politics and money should be transparent. The attempt to obtain peerages for four of them, which was blocked by the House of Lords appointments commission, came uncomfortably close to connivance by Mr Blair in a form of corruption.

For a voting (and increasingly non-voting) public whose cynicism is relentlessly fed by the brave and stainless media, nothing could be more corrosive of what little faith they have left in the conduct of democratic politics. Yet it is hard not to feel a twinge of sympathy for Mr Blair.

First of all, he was leading a party that faced what he knew would be a closely fought election against a well-funded rival. Whatever Michael Howard's other failings, his aura of purpose and professionalism had opened up the chequebooks of Tory donors. Meanwhile, Labour had debts of nearly £16m and income that fell short of its expenditure in a normal year, let alone one in which there would be a general election. Mr Blair may also have felt some personal responsibility for the party's financial plight because of the exodus of paying members from Labour following “his” Iraq war.

Secondly, those in the party who now point the finger at Mr Blair and claim ignorance of the loans brought in by his friend and fund-raiser, Lord Levy, are more complicit than they are willing to admit: there is something of the Tessa Jowell defence about their protestations. How else did they think Labour had managed to fight an £18m election campaign?

Thirdly, although Labour exploited a legal loophole in not making public the identities of donors who had lent it

money, the Tories did the same. Nor does David Cameron deny that many of the party's supporters in the House of Lords were generous donors before they arrived on the red benches.

Both parties, and the Liberal Democrats too, are victims of a growing crisis in the way politics in Britain is funded. In the last 50 years, party membership has fallen by about 85%, and attempts to maintain subscription income by gouging ever-increasing sums from the 500,000 or so eccentrics who remain are only accelerating its decline.

Meanwhile, two of the other main props of party funding have also decayed. Corporate donors, who traditionally helped the Tories, have all but vanished, frightened off by a combination of recent transparency regulations, the rise of shareholder activism and the belief that Labour no longer threatens their interests. For its part, although Labour still gets about 40% of its funding from affiliated unions, falling memberships and declining influence over party policy have steadily reduced the union contribution to party coffers over the past 20 years.

As a consequence, both the major parties have come increasingly to rely on a fairly small number of the self-made rich—mostly the heads of privately held businesses or men who have done well in the City and from property development—to help them balance the books.

Despite the unexpected television ratings triumph of “The Apprentice”, Britain is a country that is still suspicious of entrepreneurial success and “new money”. It is only too easy to portray those who enjoy both as slightly dodgy. From that premise it is no great leap to cast doubt on their motives for political giving. On March 21st, after Labour had finally revealed the names of its dozen big lenders, the *Daily Mail*'s front page asked, “So what's in it for them?” Since making a large donation to a political party is guaranteed to invite a degree and type of scrutiny of a kind that no donor would enjoy, it's not surprising that both Labour and the Tories concluded that a loan and anonymity might be best for all concerned.

Party poopers

The upshot is that the present system of financing politics in Britain is broken beyond repair—something that all the parties are now quietly agreed on. Unfortunately, they have been too cowardly to make the case publicly for a different system until now. When, in late 2003, the Electoral Commission commissioned polling on public attitudes to party funding, it found that 63% thought the cash should come entirely or mainly through donations rather than through taxation. What should worry the parties still more is that it emerged from focus groups that few people had more than the haziest notion what they contributed to democracy or why they needed money to function.

Sir Hayden Phillips, a retired senior civil servant appointed by the prime minister last week to look into party financing, will complete his report later this year. Sir Hayden is almost certain to recommend some modest form of state funding linked to votes cast in elections and party membership rolls. After haggling over the details, Mr Blair and Mr Cameron will jump at it. The hard part will be convincing suspicious and bloody-minded voters that it is in their interests too.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Coming out

Mar 23rd 2006
From The Economist print edition

AP

China hopes to use the 2008 Olympics in Beijing to mark its emergence on the world stage. But, says James Miles (interviewed here), it still has plenty of things to fix at home

Get article background

"CHINA is a second-rank middle power that has mastered the art of diplomatic theatre: it has us willingly suspending our disbelief in its strength." So argued the late Gerald Segal, a British scholar, in 1999 as the country reeled from the Asian financial crisis and fumed impotently as NATO attacked Serbia. China was then merely "a theoretical power", and seriously overrated in terms of international trade and investment. Mr Segal made a powerful case that China mattered far less than many believed. Today it is hard to dispute that China matters far more than it did seven years ago.

Yet there is no other important country whose likely trajectory over the next 20 years is more uncertain than China's. Possibilities include:

•An economy that continues to boom as the political system gradually becomes more liberal and China becomes an increasingly positive force in the world;

•A fast-growing economy, a surge of vengeful nationalism and an attempt by China to displace American power in Asia, regain Taiwan and challenge Japan;

•A country in disarray, engulfed by social and political crises as its economy slumps.

All are plausible. Much will depend on choices made by China itself and by other powers, especially America.

That China does matter is evident from its impact on the global economy. Since 2000, China's contribution to global GDP growth (in purchasing-power-parity terms) has been bigger than America's, and more than half as big again as the combined contribution of India, Brazil and Russia, the three next-largest emerging economies. China's massive build-up of American Treasury bonds affects American interest rates and thus Americans' willingness to spend. Its low-priced manufactures give western consumers more buying power. Its thirst for energy has helped push oil prices to record highs. Its entry to the World Trade Organisation in 2001 has speeded up the opening of the world's biggest market. Whereas a few years ago it might not have mattered much to the West if China's growth had faltered, today it would be a very different story.

China's growth and increasing confidence is also beginning to affect the way it behaves on the world stage. If only tentatively so far, it is beginning to act like a big power. A country that once preferred to stay clear of multilateral diplomacy is now at the centre of multilateral efforts to persuade North Korea to abandon its nuclear-weapons programmes. It has formed a club of central Asian powers to deal with security threats. Its secretive armed forces

are reaching out to other countries by staging joint manoeuvres (though not yet with the Americans or the Japanese). And China's burgeoning demand for oil and other commodities has made it cosy up to countries whose unsavoury behaviour matters to the West, such as Iran.

Over the next few years China's Communist Party leaders will face a series of challenges. Abroad, perceptions of China will change as the country's surging economy affects the lives of people around the world. In places that are important to China, from Tokyo to Taipei to Washington, DC, there will be changes in political leadership. At home, rapid growth will bring social and economic turbulence. And next year there will be an important quinquennial party conclave, followed by the Olympic Games in Beijing in 2008.

The world is expecting more of China, and so are its own people. This will become increasingly clear in the build-up to the Olympics. For China, these will about far more than sport. They will be much the biggest international event ever staged on its soil: a coming-out party of huge symbolic importance. They will mark China's full rehabilitation in western eyes after the bloody suppression of the Tiananmen Square protests in 1989. They will also be a chance to show off what the chief day-to-day organiser of the Beijing Olympics, Liu Jingmin, calls “an industrial revolution on a much bigger scale than Europe's”. Ambitiously, in a country that has one of the world's smoggiest capitals, Mr Liu says he wants a “green revolution” too.

A property-owning non-democracy

Accompanying China's industrial transformation has been another revolution of profound significance. Since the late 1990s, urban China has privatised housing, a commodity once exclusively in the hands of the state. A property-owning middle class is not only fuelling a surge of consumption but also developing a keen desire to protect its property. Few see much benefit in trying to overthrow the party: that, they fear, could cause chaos and an even bigger threat to wealth. But many want better governance and a legal system that protects them. And all but the very richest complain bitterly about a government that, despite strong and growing revenues, has presided over the collapse of affordable health care and education.

Farmers want change too. The past few years have seen an upsurge of peasant protests, many of them about the rapid encroachment of cities into rural land. As this survey will argue, China needs another ownership revolution, this time in the countryside. One of the most damaging and socially divisive legacies of Maoist economics is the control of rural land by village “collectives”. The rights of farmers in these collectives are ill- defined. In practice, rural governments regard the land as theirs and use it to fill their coffers. Many millions of farmers have been pushed off their fields with little if any compensation, and anger is growing.

President Hu Jintao, who in 2004 assumed full authority in the communist country's first ever peaceful handover of power, has set his sights high. Abroad, he wants to convince the world that China's rise poses no threat to other countries. At home, he hopes to create a “harmonious society”. This means one less obviously riven by huge disparities in wealth and access to services such as schools and hospitals, and one less troubled by protests.

The party conclave late next year, known as the 17th Congress, will be the first such gathering with Mr Hu in undisputed command (insofar as anyone can tell in China's opaque political system). It will be an important opportunity for him to indicate how a still unreformed and dictatorial party can give the public a greater say in addressing these growing social problems. And it will be a chance, less than a year before the Olympics, to show the world that against the background of China's remarkable economic change, the party is changing too.

Political reform matters. Without it, it is hard to imagine how China could make the kind of stable transition to democracy that Taiwan has achieved; and an unstable China is more likely to pose a threat to the outside world. The past few years have seen signs that the party wants to use nationalist sentiment to bolster its legitimacy. The dangers of this approach became evident in 1999, with an explosion of anger across urban China about the accidental bombing of China's embassy in Belgrade by American warplanes. Last year similar outrage was directed at the Japanese, with sometimes violent protests in several cities triggered by territorial disputes and Japan's wartime history. Such unrest worries other countries, and it worries China's Communist Party too, even though it plays a large part in fuelling it.

The Bush administration is trying to cajole China away from seeing the global balance of power in zero-sum terms and persuade it instead that a rising China and a strong America could not only coexist but thrive together. In September last year, Robert Zoellick, America's deputy secretary of state, said he hoped that China would be a “responsible stakeholder” in the world community. That has now become one of America's favourite terms in its discourse with China. It means that America wants China, a veto-wielding member of the United Nations Security Council, to look beyond its narrow self-interest in its international dealings. China's handling of the nuclear crisis in Iran will be an important test. Reassuringly, at least in its relations with America, China for now seems to be guided more by pragmatism than by competition. And just as reassuringly, America is encouraging it in this.

Barring a sharp slowdown in the global economy or some huge crisis at home, China is likely to maintain strong growth for the remainder of this decade. This gives its leaders more leeway to sort out its banking system, deal with the land-ownership problem, fix health care and education (which will involve big changes in the country's fiscal system) and set up a credible social-security safety net. If it fails to do so in the next few years, it will store up potential crises for the decade beyond, when China's working-age population will begin to decline and a rapidly ageing society will loom closer.

Beware of Latin Americanisation

Efforts to tackle such issues are motivated by fear of unrest. Officials are well aware of China's vulnerability to the sort of sudden political crisis that caused the collapse of communist governments in Russia and eastern Europe less than two decades ago. In the official media, a fashionable new topic is the potential “Latin Americanisation” of China: the possibility that growing income inequalities and an ill-regulated rush to privatise could precipitate economic and political upheaval. Just as the implosion of communist regimes elsewhere encouraged the late Deng Xiaoping to launch wealth-generating market reforms in the early 1990s, fears of instability caused by today's inequalities at home are prompting the government to try to find ways to help the marginalised.

This survey will argue that such fears are sometimes exaggerated by a party that until 15 years ago controlled almost every aspect of its citizens' lives. The party is finding it hard to adjust to what many developing countries would regard as normal teething troubles. China's rapid economic growth endows it with a critical mass of people who expect their lives, or at least those of their children, to get much better in material terms than seemed possible until quite recently. Reports of protests here and there have become part of the background noise of urban life.

But rapid economic growth cannot be expected to last forever, and the party is acutely aware that, apart from its ability to deliver wealth to some, it lacks a strong legitimising force. Conscious of the country's volatile history, it is especially alarmed by the growing unrest among a rural population (still the majority) that has benefited far less from China's economic rise than have many urban residents. It was after all, a peasant rebellion that helped the communists to power. And although it is safe to rule out another such revolution, rural discontent is nevertheless a big political challenge for Mr Hu.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Fat of the land

Mar 23rd 2006
From The Economist print edition

But only for a select few

IN PINGGU district, a mountainous and largely rural area in north-eastern Beijing, local officials are keen to show off how they are implementing one of the Communist Party's latest directives. It is, like all party initiatives, encapsulated in a slogan: “Promote the construction of a new socialist countryside.” The idea is to narrow the widening gap between rural and urban China, defuse unrest and turn the country's 800m rural residents into economy-boosting consumers.

In Bolitai Village, perched on a slope beneath the scenic ruins of the Great Wall, building a “new socialist countryside” has meant bulldozing peasants' decrepit houses and replacing them with cheery-looking two-storey villas with solar heating panels on the roofs and broadband internet access. Pinggu's plan is to enrich remote village communities by turning them into weekend hideaways for a new middle class in Beijing that now has cars and thus the means to roam. The government provides grants and arranges low-interest loans for construction, and encourages lots of official delegations to visit.

The revamped Bolitai looks garishly new, and insofar as it involves an entire community falling in with a government-inspired project (barring one old man who has refused to rebuild his house), it has the feel of Chinese socialism. Pinggu officials boast that their “new socialist countryside” campaign got started before the idea became party policy last October. The party plans to boost spending on rural infrastructure including roads, schools and hospitals, abolish all school fees by the end of next year and step up efforts to provide peasants with health insurance. But none of this will tackle the root of China's rural problems: the ownership of land.

Reports of large-scale and sometimes violent rural protests have become ever more frequent in recent months. In June 2005, government-hired goons in Hebei Province killed six peasants in a battle to enforce a claim on a piece of farmland by a state-owned power plant. The following month, hundreds of villagers in Taishi in Guangdong province launched a campaign to oust their village head whom they accused of misappropriating money from land sales, leading to violent clashes. In December, police shot dead as many as 20 villagers in Dongzhou in Guangdong province in another fight over land claimed by a power plant. In another Guangdong village, Panlong, a girl was killed in January when police clashed with farmers.

At a party meeting in December, China's prime minister, Wen Jiabao, reflecting the leadership's growing anxiety over such unrest, issued a warning against making “historic errors” over rural land. The protests suggest that the party's strategies for taming rural unrest have failed. In the 1990s, one answer was thought to be village democracy. Residents were allowed to elect their leaders by secret ballot. But in many villages the experiment dissolved into power struggles between elected chiefs and the party's own unelected representatives. The party made it clear that the party secretaries were to remain in overall command, and the peasants' enthusiasm dwindled.

Another strategy has been to boost rural incomes. In 2000 the party began to abolish a wide range of fees levied on farmers by local governments. In 2004 it offered farmers direct subsidies for growing grain. From this year, it has abolished an ancient tax levied on peasants according to the amount of land they hold. Real rural incomes in 2004 grew by 6.8%, the highest annual rate since 1996, and in 2005 by 6.2%. But urban incomes last year rose by 9.6% and, especially on the periphery of urban areas where land is being seized fastest, there is still much anger and resentment in the villages. Estimates vary, but most agree that tens of millions have lost some or all of their land since the early 1990s, often without compensation.

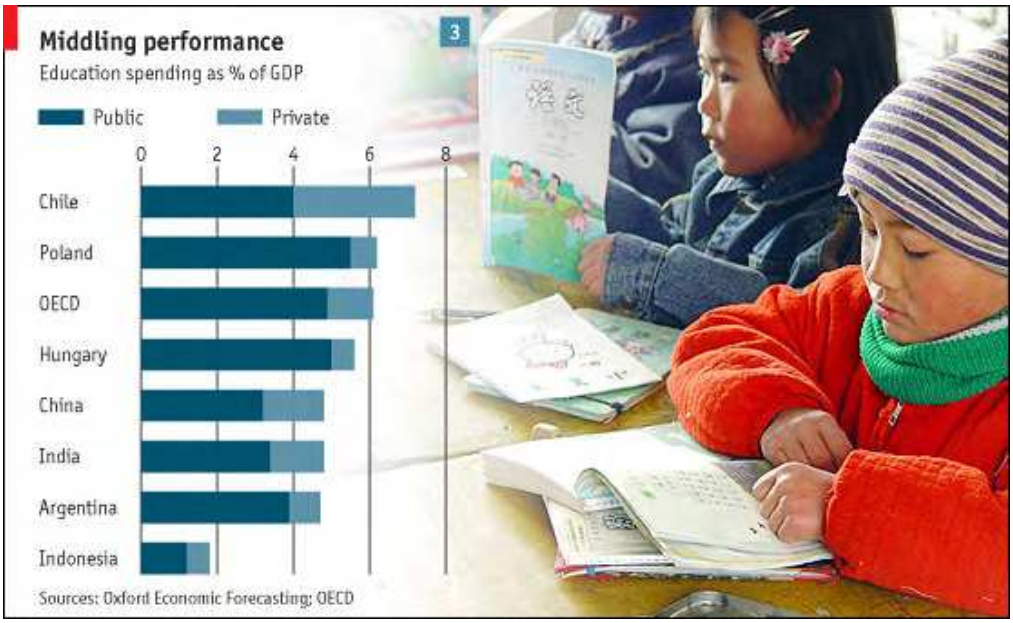
Not for keeps

The problem goes back to Mao Zedong. One of the first things he did on taking power in 1949 was to seize land from landowners (killing thousands of them in the process) and redistribute it to peasants. In the 1950s he took the land away from them again and put it under the “collective” ownership of communes. The communes were dismantled in the early 1980s, a few years after Mao's death. Peasants were allocated plots of land to farm as they wished, but ownership remained “collective”. Since the 1990s, leases of 30 years (but in practice often less) have been granted on these tiny plots, but peasants have not been able to use the land as collateral for loans or to sell it. They can rent it out, but this often involves paying a fee to the village administration.

So whereas trade in land and property has become an important engine of growth in urban China (where residential leases run for 70 years and others for 40 or 50), farmers have been cut out of this boom. Li Changping, a former township party chief who has become a prominent critic of the government's rural policy, says that by limiting leases to 30 years the state is in effect asserting its control of the land over the village collective. This reinforces local governments' belief that land is theirs to grab.

China's rural-land problem is exacerbated by a dysfunctional system of fiscal transfers that leaves many local governments unable to pay for basic services such as health care and education. China is among the most decentralised countries in the world as far as paying for local services is concerned (“the central government invites the guests, the local government pays the bill,” goes a popular saying). A half-baked attempt at reform in 1994 has favoured wealthier regions.

Imaginechina



Abolishing rural taxes without putting in place an alternative way of funding public services has simply made the problem worse. Land has become an even more vital resource for local governments, which either hand it over for little or nothing to attract industry or sell it at high prices to property developers. They also use requisitioned land as collateral for bank loans, adding to the potential woes of a banking system in which risk is poorly understood. Total debts of township and village governments alone may amount to well over 1 trillion yuan ($125 billion), or more than 5% of GDP.

When land is seized, peasants are compensated for its agricultural value, which according to some Chinese scholars averages about one-tenth of its market value. Village administrations take a cut, so the amount received by the peasants is often far less. By contrast, in the cities the privatisation of housing since the late 1990s has created a middle class that is using its property as collateral to borrow. Trading property has become a big source of urban wealth. Of China's 50 richest people, about half owe their fortunes in large part to property deals, according to Rupert Hoogewerf, the author of China's first rich list.

Scattered and ill-organised rural protests are unlikely to turn into a serious threat to the party. China's political future depends largely on stability in the cities. Mao's armies of landless and disgruntled peasants would be hard to recreate in today's more effectively controlled China. But the protests are a serious embarrassment to the current leadership, and they are likely to get worse as the cities expand relentlessly.

Some Chinese scholars suggest curbing the powers of rural governments to appropriate land, and giving individual peasants the right to trade it, mortgage it or keep it indefinitely. Secure rights would encourage farmers to invest more. This would help make land more productive. Giving farmers the right to negotiate the sale of their land to developers directly would greatly improve their chances of realising the market value of their holdings. And restricting land seizures could help push up the price of land on the periphery of urban areas and encourage a

more rational use of existing urban land. Such measures could also help ease the government's worries about the loss of food security arising from the rapid encroachment on rural land.

There is huge resistance to change. One reason is that allowing the “marketisation” of rural land would be seen as a direct assault on party ideology. But to a party that cares more about its survival than it does about communist principles, a more important consideration is the risk of instability. It fears that creating a free market in rural land would prompt peasants to sell their holdings to pay their debts, sending an avalanche of landless farmers to cities that have no social-security infrastructure to deal with them.

The party's fears are overblown. Given the parlous state of urban China's social-security system, peasants would continue to regard land as a vital safety net, to be relinquished only in extreme circumstances. True, the system that kept rural and urban China rigidly separated is gradually being dismantled to allow cheap rural labour into the urban workforce; but migrants from the countryside generally get the most menial jobs, miss out on subsidised health care and are often denied access to oversubscribed urban schools. And if they cannot find a job, they will find the cities prohibitively expensive.

Reform by stealth

To make rural land reform work, fiscal transfers from the centre to the provinces would also have to be made fairer, and that too would require considerable political will because richer provinces would be reluctant to lose their advantages. However, the government is inching in the right direction. In 1998 it ordered written land-use contracts to be issued to peasants (though this rule is widely ignored). A law introduced in 2003 restricted the right of collectives to reassign land within villages and provided a legal basis for transfers of land between peasants for farming.

Reform by stealth has been a hallmark of much of China's economic transformation in the past quarter-century. The leasing of land to households in the early 1980s began as a grassroots initiative that gradually gained official support and was already being widely practised by the time it was given the party's formal approval. Late last year in Guangdong province, one of China's most affluent regions (and also the scene of some of the most violent peasant protests reported recently), the authorities began allowing villages to trade land that had already been converted to industrial use. This step was hailed by one state-controlled newspaper as the start of a “new land revolution”.

But the “new socialist countryside” now being championed by China's leaders is unlikely to bring a sweeping change in the way rural land is organised. Chinese officials have been inspired by South Korea's “new village movement” launched in the 1970s, when that country was similarly worried about rapid urbanisation and the wealth gap between urban and rural areas. South Korea's government spent heavily on rural infrastructure and on providing farmers with building materials. But the Chinese have made little mention of South Korea's earlier land reform in 1949 which gave secure marketable rights to former tenants, and which proved to be a key factor in South Korea's successful transition from agricultural economy to industrial powerhouse. Still less have they dwelt on Taiwan's similar and highly acclaimed land reform of the early 1950s.

Incremental steps over the next few years towards the creation of a rural land market and a reduction in local governments' share of health-care and education costs would give farmers a far better chance to prosper, whether on their land or in the cities. That would be good news for China's economy, which badly needs a new engine of consumer-led growth.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

A piece of the action

Mar 23rd 2006
From The Economist print edition

How one rural community hit it lucky

THE village of He Hua in Wenzhou municipality, about 365km (225 miles) south of Shanghai, is a typically bizarre product of China's bipolar economy with its rigid distinction between urban and rural. A stranger looking at its streets lined with shops, restaurants, office blocks and apartment buildings would have no idea that it is a village at all. It looks just like any other urban area of Wenzhou, one of China's most prosperous cities.

The rapid outward expansion of Chinese cities in recent years has swallowed many villages like He Hua, which 20 years ago was an expanse of paddy fields. Sometimes the land is appropriated by the government and sold on to developers, with some of the money being used to rehouse the villagers who are reclassified as urban residents. But often villages have remained villages, looking urban but governed by different economic rules. He Hua is one of those.

The He Hua village office, down a shabby alleyway next to a luxury housing development, is now the headquarters of a property company that is making good use of the village's virtual existence within Wenzhou's urban sprawl. These “villages within cities”, as they are called, can take advantage of urban housing demand to rake in fortunes with their remaining plots of collectively owned land. And if the villagers are lucky, as they are in He Hua, they will get a generous share of the money.

He Hua's village committee is just about to redesignate itself as the He Hua Village Economic Shareholding Co-operative, a process that has taken four years. The elected village chief has become its general manager. The village's former Communist Party leader is now chairman of the board. All this has taken a long time to organise because assets had to be valued and, most contentiously, shareholders identified. Only villagers can be shareholders, but it was not easy to decide how to deal with villagers who had moved elsewhere and wanted to come back to enjoy the spoils.

Outside the village office, with its new Shareholding Co-operative nameplate, are the fruits of all this toil: sheets of paper on a bulletin board listing the 363 shareholders. They make up less than a quarter of the area's current population. Mao, who famously said that women hold up half the sky, would not be happy with the list. He Hua has decided that when it comes to share allocations, women are worth only six-tenths of men. Jin Zhengzhong, the general manager, explains that this is based on traditional rural reckoning which values a woman's labour at half that of a man's. But even this is progress of sorts: before the new co-operative was established, profits were handed out only to male family heads, to divide up as they wished.

Turning villagers into shareholders is a big improvement on the hazy “collective” ownership notion prevailing in most of rural China. But although He Hua's villagers will be rich by local standards (an adult male shareholder can expect a dividend of $5,000 a year, which amounts to a comfortable urban income), they have not found the answer to China's land problem. Their shares will be diluted if their numbers grow; they cannot be sold except to other villagers; and the government could still take the land away.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Keep growing

Mar 23rd 2006
From The Economist print edition

We've come to help with the pension crisis

Easier said than done

SHOULD China's growth falter, the country's ability to maintain social and political stability would be in great doubt. A prolonged slump in property prices would confront homeowners with their first taste of negative equity and banks with a millstone of bad loans. Urban unemployment would rise perilously. Bottled-up grievances over corruption and poor governance could set off open unrest with support from an urban middle class no longer so enamoured of the status quo.

But how likely is that? For a quarter-century, China has officially enjoyed average annual GDP growth rates of more than 9%. Even allowing for occasional over- and underestimates, average rates may have been higher than those achieved by any other Asian country during a similar period of rapid development. China suffered sharp slowdowns in the early 1990s and again later that decade, but quickly recovered. Those who predicted a hard landing for the country's economy two years ago as it applied the brakes have been proved wrong, at least so far. Growth in 2006, barring some calamity, looks likely to be only slightly lower than last year's 9.9%. Few expect a protracted slowdown in the remaining years of this decade.

However, big problems need to be tackled if China is to maintain rapid growth through the next decade. “We've pretty well done the easy reforms. What's ahead are the difficult ones,” says Gao Shangquan, a senior government adviser. These include a state-owned banking system burdened with non-performing loans, a state sector which despite considerable trimming remains massive and inefficient, and a social-security system that does not live up to the name. If China fails to deal with these, it could find itself going through the same experience as Japan in the 1990s, when bad loans led to a credit crunch and a long economic slowdown.

China's economy has a number of strengths beyond its rapid growth. Government finances appear reasonably healthy, with national revenue growth averaging 18% a year since 1994, a deficit of 1.6% of GDP and public debt of less than a quarter of GDP (see chart 4). This gives the government some room to pump up the economy if need be. China has one of the world's highest saving rates, at some 40% of GDP, and foreign-exchange reserves of $845 billion, second only to Japan's.

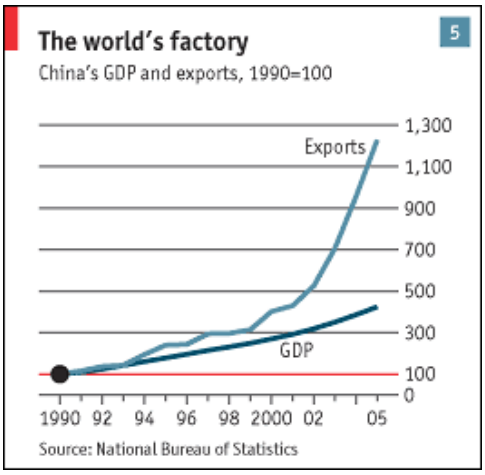
The country is making some headway against its problems, partly by design and partly thanks to rapid growth. It has laid off 20m-30m workers from state-owned enterprises (SOEs) in a huge wave of closures, mergers and privatisations that has halved their number since the mid-1990s. Although this has pushed up unemployment, many workers have been absorbed into the rapidly expanding non-state sector. SOEs now account for less than one-third of GDP, against almost all of it in the early 1980s. But that still leaves nearly 140,000 of them, employing 40m people. The state sector still accounts for more than half of all industrial assets, only ten percentage points down on 1998. More

than one-third of these SOEs are making no return on their investment and need to be closed down or sold off.

On the brighter side, profits in the 169 large centrally controlled enterprises grew by nearly 28% to $78 billion last year. In bigger SOEs, efforts to remove the state from day-to-day control, introduce western commercial practices and strengthen the role of shareholders are making progress. The creation in 2003 of a new body to manage non-financial state assets, the State-Owned Assets Supervision and Administration Committee, has put a buffer between government and enterprise management and clarified rules for restructuring. A new bankruptcy law could be adopted this year, though it remains to be seen whether this is good for banks, whose claims come low in the pecking order under current legislation. The government's priority has been to pay off workers.

With half of all bank loans going to SOEs, the problems of the two sectors are closely interlinked. But even in banking, which many regard as the weakest link in China's economy, there has been some progress. There is less talk now about a possible banking crisis than there was at the beginning of the decade. Non-performing-loan ratios remain high, perhaps twice as high as official figures put them in the “big four” state-owned commercial banks. But following the transfer of 1.4 trillion yuan of non-performing loans to asset-management companies in 1999, a series of capital injections into the banks since the late 1990s and a tightening of credit management, three of the big four—Bank of China, China Construction Bank and the Industrial and Commercial Bank of China (ICBC)—are looking somewhat healthier. They have introduced stricter monitoring of non-performing loans and trimmed their staffs by a total of nearly 250,000 people. UBS, an investment bank, reckons that the non-performing-loan stock of the big four and other Chinese banks is now only around 30%, half of its peak level in the late 1990s (though that would still make China's one of the worst banking systems in Asia).

These moves have helped prepare the banks for listings overseas, which are intended to sharpen their operation as commercial institutions. China Construction Bank launched its initial public offering in Hong Kong in October 2005. Bank of China and ICBC, which has the biggest assets of the commercial banks, say they are getting ready to follow suit this year and expect to raise $5 billion-10 billion apiece.



In advance of their listings, the banks have also been selling strategic stakes to foreign financial institutions. But foreign ownership of banks is capped at 25%, and it is not clear how much say in management these investors will be given. Wu Xiaoling, a deputy governor of the central bank, the People's Bank of China, says the government has no plans to surrender control of any of the big four within the next five years. The party still regards state ownership of the banks as a vital bulwark against financial instability. It knows that this often leads to unproductive investments. But it also shores up public confidence in the banking system, which is essential for maintaining the flow of savings and foreign investment.

Chinese banking officials admit there is a need for foreign expertise, but fear that encouraging the development of privately controlled Chinese banks would exacerbate financial risk. As Ms Wu explains, private investors in China tend to regard such banks as vehicles for raising money for their own business interests, and private business interests can be very murky. In 2004, the government took over D'Long, a private investment firm in Shanghai that was billions of dollars in debt. It was a signal that the state will still intervene if it thinks that a company's collapse might threaten social or economic stability.

Too much saving is bad for you

With its huge foreign-exchange reserves, strong revenues and low deficit, China still has the wherewithal to prop up its banks. The saving rate is likely to remain high, given concerns about pensions and other social-security provisions. And there are few other places for savers to put their money: China's SOE-heavy stockmarkets have been among the world's worst performers in the past five years, and controls on capital outflows remain largely effective. The opening up of China's banking system to foreign competition at the end of this year—a commitment made by China when it joined the WTO—will have little effect in the short run because Chinese regulations make the cost of setting up large branch networks prohibitively high.

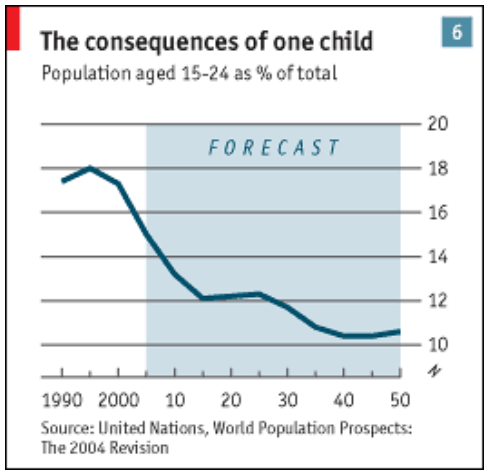
But if China's growth is to be led by consumption rather than by investment and exports, as most analysts agree it needs to be in order to avoid boom-bust cycles and growing friction with trading partners, the country will need to

get used to a lower saving rate. And the banks are still in poor shape. A large share of lending from the boom of 2001-04 could turn into bad debt. Although official figures for non-performing loans look encouraging, they mostly rely on the accounting trick of moving such loans into asset-management companies. China's property market, though sustained by strong demand for new urban housing, could turn into a bubble.

Boosting private consumption could be difficult in a country with a GDP per person of only $1,700, especially given the absence of a comprehensive social-security system. The government needs to boost its own consumption first. This means spending more on health care and education, and expanding the social-security network in rural as well as urban areas. Changing demographics make this all the more important. Over the next 10-15 years, the rapid ageing of the population will increasingly make itself felt. As the labour force begins to shrink, the current pay-as-you-go pension system will become unsustainable. Life expectancy in China is high by the standards of developing countries and is likely to go on rising.

Goldman Sachs, an investment bank, reckons that China's "demographic bonus" of a large working-age population with a small number of dependants (helped by the one-child-per-couple policy introduced in the late 1970s) will shortly run out as the number of young workers starts declining (see chart 6). The country's dependency ratio will begin to rise by 2010, whereas India, on current trends, will not reach that point until 2040.

The government has been trying to develop a new pension system, including elements of both pay-as-you-go and funding, whereby it invests on behalf of workers and then pays them pensions from their individual accounts. But it will be many years before China has a sufficiently mature bond and equity market to make this workable. Yields on domestic bonds are low, and the 15-year-old stock exchanges are still hardly worthy of the name. The cost of establishing the new funds at the same time as meeting current pension obligations will be very heavy. It could be reduced by bringing more workers into the scheme (at present only one-third of urban employees are covered, and rural residents not at all), but it would be difficult to persuade them to take part in such a seemingly risky venture. With no expansion of pension coverage, liabilities for future pension payments could amount to 70% of current GDP.



But Goldman Sachs argues that the effect of China's growing dependency ratio will be mitigated by the rising productivity of an increasingly well-educated workforce. It could also be counteracted by productivity gains as more people migrate from rural to urban areas if China can sort out its rural land mess. Officials are considering an easing of the one-child policy, which could help as well.

President Hu and Mr Wen have signalled a greater willingness to spend on public services. They have repeatedly stressed that they want to steer China away from an environment-destroying blind pursuit of economic growth, devote more resources to health care and education and reduce inequalities. Their curious choice of slogan is, "Put people at the centre"—a phrase that in China is known mainly as the Chinese rendition of Nokia's trademark slogan "connecting people".

However, the new five-year economic plan adopted in March gives little hint of any fundamental shift in spending priorities. It modestly calls for a mere doubling of GDP per person between 2000 and 2010, which implies that the current GDP growth rate might slow down considerably. The plan modestly forecasts an average annual growth rate of 7.5% for the next few years. But in their own five-year plans many local governments are predicting double-digit growth. High growth, the party believes, is still vital to its grip on power. And for the foreseeable future this will mainly come from the same sources as it does now: investment and exports.

In this, China is following the development pattern of several other Asian economies before it. But along with economic growth will come rising expectations—on the part of Chinese citizens for a greater say in decision-making, and on the part of the rest of the world for a China wedded not just to capitalism but to the principles of open government, private initiative, sound corporate governance and legal impartiality. Elsewhere in Asia, rapid growth has often gone hand in hand with political change. China's leaders know that both the world and their own people are watching closely.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Good things in tiny packages

Mar 23rd 2006
From The Economist print edition

AP

A little democracy has to go a very long way

JIN LIANGMING, the party chief of the booming Xinhe township on the coast of Zhejiang province, has something unusual to show a visiting foreign journalist: a detailed (by Chinese standards) budget report for his government. Many Chinese officials would worry about losing their job or even going to jail for this, but when your correspondent asks for a breakdown of its implementation, Mr Jin gets detailed monthly statements printed out.

Government budgets in China are usually treated as secrets, except for vague headline figures issued for public consumption. The annual state budget is a flimsy pamphlet that gives only a broad outline of spending priorities and commitments and says nothing about budgets for individual ministries. Deputies in the Communist-Party-controlled legislature pass it without amendment (the latest went through on March 14th).

It is a sad reflection on China's progress towards more open government that the bits of paper supplied by Mr Jin seem so exciting. Whereas economically China has surged ahead in the past few years, politically it remains almost as secretive, just as risk-averse, nearly as dictatorial and every bit as determined to crush any organised dissent as it was at the turn of the decade.

Gone are the days when foreign observers celebrated China's efforts to promote a semblance of village democracy in the 1990s. Many thought this might be the start of a gradual rise of democracy from the grassroots. But although a handful of townships (the first tier of government—village administrations formally do not count) have tried to introduce similar reforms, the central leadership has done little to encourage this. Last September the prime minister, Mr Wen, hinted that townships could have direct elections within a few years, but his statement was loaded with ambiguity.

Even for a government reluctant to reform, making the budgetary process more open to the public looks promising. Unlike direct elections at the township or higher levels, making government budgets more transparent would not require any constitutional change. It would be in keeping with the principle of open government to which China's new leaders have paid some lip service. It could help reduce some of the bureaucracy's prodigious waste. And making government budgets more open would go to the heart of the democratic process, giving the public a say in how public resources are deployed.

Mr Jin is not quite alone in his experiment with openness among the paddyfields, clothing factories and scrapyards of Xinhe (population 120,000). The province of Guangdong (population 83m), like Zhejiang one of China's wealthiest, has inched along the same path. In 2004 it handed deputies to the provincial legislature a budget report of over 500 pages. But it was marked “secret”, and they had only two days to study it before voting on it and handing it back.

Xinhe's budget reform, launched last year, is being promoted as a model by reform-minded Beijing academics and encouraged by moderately reformist party leaders in Zhejiang. But not even its neighbours are yet following suit, let alone the 43,000-odd other townships in China. “There are many leaders better than us,” laments Mr Jin. “But the problem is they don't have the courage.” Even his new-look budget report does not tell all. It provides no clues, for instance, to the complex web of extra-budgetary flows managed by every tier of government, including their dealings through government-owned companies. But it does usefully—and unusually—admit that the township is in debt to the tune of more than $6m.

While the world is watching

The budget experiment is unlikely to take off in a big way. Serious political reform is not currently on the party's agenda, and is unlikely to get any attention until after the Olympic Games, if then. Many observers see little hope of any significant movement until after 2012, when a new generation of leaders is due to take over. For now, President Hu and Mr Wen appear far more concerned with maintaining stability than with the long-term challenge of moving to a more pluralist system.

China's leaders are worried that international attention focused on China in the run-up to the games could encourage disaffected citizens to air their grievances. The Tiananmen Square protests in 1989 gathered steam when hundreds of foreign journalists poured into Beijing to report on the first summit meeting between China and the Soviet Union since the end of the cold war—and found themselves diverted by swelling crowds of demonstrators. The protesters calculated that the authorities, anxious not to tarnish China's image in front of the Soviet president, Mikhail Gorbachev, as well as the world's media, would leave them alone. They were partly right: China waited until the day after Mr Gorbachev left before declaring martial law. The media stayed on.

AP

Hu and Wen have their hands full

The Olympics in 2008 are likely to attract more than 20,000 foreign media representatives, who will be accredited not by China but by the International Olympic Committee. It will be by far the biggest media event in the communist nation's history, testing its ability to accept critical scrutiny to the limit. China's strategy, it seems, will be to try to ensure that nothing untoward happens in the run-up to the event. It is keenly aware of unrest in other Olympic cities ahead of the games. Both Mexico City in 1968 and Seoul in 1988 saw large anti-government protests. Mexico's ended with a bloody crackdown.

But unlike the Mexican authorities, the Chinese ones appear to have mobilised broad support for the games. And unlike in Seoul, where public sentiment was still inflamed by a massacre of protesters in Kwangju eight years earlier, there is no particular rallying cause in China today. The 1989 killings in Beijing have become a distant memory. Although many Chinese citizens have grievances against officialdom, these would be hard to galvanise into an organised protest movement.

Opinion surveys suggest that despite frequent public protests in the countryside as well as in the cities, the central government still enjoys a considerable degree of support. Government becomes increasingly unpopular further down the hierarchy. Thus angry peasants direct their resentment at rural authorities rather than at the central leadership or the Communist Party. According to Tony Saich of Harvard University, a survey spanning the past three years shows that support for the central government has remained “extremely high”. This, he says, fits with a traditional Chinese view of government that “there's a good emperor there if only we can get through to him.” Thousands of people go to Beijing every year to ask the central government to redress local injustices. Their inevitable disappointment does not appear to dim their belief that it is local government, rather than the top leadership or the system itself, that is the problem.

But the authorities are still jittery. President Hu's assessment of threats to the party's rule appears to be much the same as that of his predecessors, despite the rapid rise in incomes in recent years. A resolution at the party meeting in 2004 at which Mr Hu consolidated his power after a lengthy co-regnum with his predecessor, Jiang Zemin, said there had been “no change in the strategic conspiracy of hostile forces to westernise and cause China to disintegrate”. The leadership has been particularly rattled by the “colour revolutions” against authoritarian governments in Georgia in 2003, Ukraine in 2004 and Kyrgyzstan in 2005.

The past few months have seen one of the most wide-ranging campaigns in recent years to stifle public criticism of the government. Outspoken newspapers have been closed or their editors sacked, pressure on non-governmental organisations has been stepped up and dissidents who have posted their views on the internet have been jailed.

Initial expectations that Mr Hu might push political reform further than his cautious predecessor have all but evaporated. Mr Hu has also presided over one of the most intensive indoctrination campaigns among party officials in recent years.

In the run-up to the Olympics, even the glimmer of democracy only just tolerated at the grassroots level is making the government nervous. That may explain why Beijing's authorities have decided to hold the next round of elections for district-level legislatures in the city at the end of this year rather than in 2007, as the rules would also have allowed. The previous round of elections in 2003 saw the first political stirrings of the city's new middle class, with several independent candidates joining the campaign (and, unusually, being left to get on with it). Many of these were relatively prosperous home owners and lawyers with an interest in property rights. It seems that the government does not want such people campaigning too close to the Olympics.

Optimists argue that the leadership's conservatism is tactical and does not necessarily signify a rigid opposition to reform. New leaderships in China have a tendency to crack down as they consolidate their power. That is what Deng Xiaoping did in 1979 when he shut down Beijing's Democracy Wall and jailed many dissidents. Jiang Zemin relentlessly pursued Tiananmen Square activists after he (nominally) took over in 1989.

President Hu, for his part, has displayed a curious streak of respect for liberal leaders of the past. He allowed hundreds of people, including dissidents, to join a funeral service for a deposed party chief, Zhao Ziyang, in January 2005. And in November he organised a public commemoration of the 90th anniversary of the birth of the late Hu Yaobang, who was also ousted because of his reformist beliefs. But in the build-up to the party's 17th congress in late 2007, Mr Hu might be eager to display his toughness.

Such congresses are mere rubber-stamp events held every five years to confirm party policy and name new leaders. The important part is the intense and secretive wrangling that precedes them. Mr Hu is limited to two five-year terms as president, and convention requires that he also step down as party chief in 2012, so it will be a big opportunity for him to begin installing his own successors. Likely front-runners for top positions include several provincial party bosses: Li Keqiang of Liaoning province in the north-east, Li Yuanchao of coastal Jiangsu province and Xi Jinping of Zhejiang, all of whom are as inscrutable as is Mr Hu.

If Mr Hu has anything interesting to say about how the party should change, the congress would be the forum at which to make it known. In the coming months, debate within the party over the way the congress should tackle such issues as political reform and better governance is likely to intensify. The approach of the Olympics will fuel that debate. A survey by a senior Chinese academic conducted about two years ago among nearly 600 provincial and lower-level party officials in one (unnamed) province found that 85% of the respondents wanted to speed up political reform and more than 60% were dissatisfied or very dissatisfied with the level of democracy in China.

One area of disagreement within the party is over the way that the hoped-for “harmonious society” should be brought about. When China acceded to the WTO in 2001, there was little public opposition to the principle of globalisation. But the past few years have seen an increasingly bitter divide among Chinese intellectuals (and party officials) over the merits of the Dickensian capitalism that China appears to have embraced. Growing inequalities of wealth and access to public services have prompted strident criticism of economic “neo-liberalism”.

Champions of a more caring, worker-friendly kind of capitalism are now dubbed the “new left”. One of their flagbearers, Wang Hui, the editor of a widely read and outspoken literary journal, *Dushu*, says workers should be allowed to have independent trade unions rather than impotent party-controlled ones. He fears the way SOEs are being privatised might create an oligarchy of a wealthy elite controlling the country's resources, as in Russia. Last year 105 new-left intellectuals submitted a letter to the leadership to protest against a government directive allowing domestic private investment in the state's hitherto jealously guarded preserves such as power, railways and telecommunications.

The leadership, with its populist bent, has shown a degree of sympathy. Partly in response to such criticisms (as well as concerns about worker unrest), it has tightened control over management buy-outs of state-owned enterprises. And it has recently put a new property law on ice. Supporters say the law is needed to reassure the private sector and the middle classes. “New left” critics say it fails to protect the “sanctity” of state property.

Turning green

Environmentalists will pitch into this debate too, encouraged by another of Mr Hu's slogans, calling for “scientific development”. China has pledged massive efforts to clean up Beijing's appalling pollution in time for the Olympics. Its best bet will be to order the temporary closure of polluting industries across a wide swathe of northern China in the run-up to the games, as well as introducing draconian traffic-control measures in Beijing. But some environmentalists are using the party's avowed interest in greenness to push for greater outside supervision of government activity in this area.

Even some officials at the State Environmental Protection Administration see the environmental cause as a low-risk way of encouraging greater public involvement in policymaking. “The government has realised that without

environmental NGOs to help them and tell them promptly what is happening on the ground, there could be sudden social turbulence," says Dai Qing, an environmental activist in Beijing. The government's tolerance has its limits, however: Ms Dai is under police surveillance.

Mr Hu doubtless wants to stop any such pressures from developing into a concerted political challenge. A year after the Olympics comes the 20th anniversary of the Tiananmen Square protests. The tumult and bloodshed of 1989 may no longer inspire passion among ordinary Beijing residents, but within the party Tiananmen is a still a sore point. Any fundamental political reform would have to begin with a reassessment of it, and neither Mr Hu nor any of his colleagues shows any sign of being ready for that.

Some liberals within the party worry privately that this reluctance to loosen its grip could make it increasingly vulnerable to unexpected shock—a sudden economic slowdown, a huge natural disaster or a health crisis such as bird flu. Such events could trigger both private and public questioning of the party's ability to rule that might shatter its unity and cause its rapid collapse. To avert such a fate, the party is turning to a time-honoured technique in times of domestic uncertainty: tapping the wellsprings of nationalism.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Pride and prejudice

Mar 23rd 2006
From The Economist print edition

If in doubt about your place in the world, fall back on nationalism

AP

Licensed to bash Japan

CHINA'S leaders bridle at the suggestion that the country's growth will be anything other than benign, or that its rise will challenge the world's status quo. But history could prove them wrong. The rapid rise of great powers has a habit of causing bloody confrontation. And when such a power harbours resentment at its past humiliation by others, covets long-lost territories and secretly and rapidly upgrades its military potential, it would seem reasonable for observers to worry.

To Chinese officials, the Olympic Games in 2008 will symbolise the country's re-emergence on the world stage after more than 150 years of humiliation and isolation by western powers. Many Chinese saw the narrow failure of their bid to host the games in 2000 as the result of malicious western attempts to keep their country in check. When its second attempt succeeded by a comfortable margin, it was seen as a belated recognition by the West that China should be treated as a respectable country. This would be its chance to show itself off as a proud, strong nation.

Party leaders hope that national pride will help the country to remain stable and united amid turbulent social and economic change. By playing to the public's patriotic sentiments, the party also hopes to strengthen its claim to legitimacy. This has been an important motive behind China' s recent push to become a space power, with the launch of two manned orbital craft in 2003 and 2005. It is possible that later this year China will launch an unmanned spacecraft to orbit the moon, a step towards an eventual moon landing by a Chinese astronaut.

This strategy of encouraging national pride also carries some risks for the party, particularly if the public feels that the government is not being nationalist enough. It means that whatever action China's leaders take on sensitive issues such as Japan, Taiwan and America will have “very broad implications for domestic politics”, as Christopher Hughes of the London School of Economics argues in a book just published. The dangers this strategy could pose for international security are even more apparent.

Ironically, the past few years of China's rapid economic rise and integration with the outside world have also brought a rising number of angry public protests over nationalist issues. In the two biggest and most unruly incidents—demonstrations against America and Britain in 1999 following the bombing of the Chinese embassy in Belgrade, and anti-Japanese protests in April last year—the government at first appeared to be condoning if not encouraging the outbursts. Those who argued that giving China the Olympics would help tame such nationalism have been proved wrong.

Nationalist tit for tat

Untamed, that Chinese nationalism risks starting a vicious cycle as nationalists elsewhere respond. The Japanese grumble about Chinese criticism of their wartime record which they regard as politically motivated. Unwilling to be

seen as capitulating to China, Japan's prime minister, Junichiro Koizumi, continues his controversial visits to the Yasukuni Shrine where Japan's wartime history is celebrated. In Taiwan, a new sense of identity is emerging that emphasises the island's cultural and historical distinctness from China. The more China attacks this trend, the more Taiwanese nationalists shout back.

The growth of nationalist sentiment in China has coincided with a double-digit increase in China's military spending every year since the mid-1990s. An uneasy Japan has been strengthening its security ties with America. It has also been manoeuvring—with some success—to keep China from turning the Association for South-East Asian Nations into the nucleus of a China-dominated grouping of East Asian countries. In north-east Asia, the two countries have territorial disputes that inflame nationalist passions on both sides.

Fortunately both China and Japan realise that they cannot afford to let these quarrels escalate. Economic interdependence between the two countries has grown by leaps and bounds in recent years. China (with Hong Kong) has helped to lift Japan out of stagnation, becoming its biggest trading partner in 2004. Last year, by Japan's reckoning, the total volume of trade between the two countries was nearly $190 billion. Japan accounted for 11% of foreign direct investment in China in the first nine months of last year, making it the biggest investor after Hong Kong. In October last year, Mr Koizumi appointed an official widely seen as “pro-China”, Toshihiro Nikai, as his trade minister.

But China has been refusing to talk to Mr Koizumi since his last visit to the Yasukuni shrine in October. And even when China is talking, the frosty state of relations makes it difficult for the two countries to establish mechanisms for dealing with sudden crises in their relationship. For several hours during last year's anti-Japanese demonstrations in Beijing, nervous Japanese diplomats were unable to reach China's foreign ministry by phone.

If a Japanese vessel were to collide with a Chinese one in a disputed area of the East China Sea, causing Chinese casualties, it is easy to imagine an outbreak of violent protests in China that could rapidly escalate. Such risks could grow as Chinese navy vessels become more active in the area. A Chinese submarine was spotted near Okinawa in 2004, and last year China briefly deployed warships near its controversial gas-drilling rigs in the East China Sea. Some Japanese diplomats fret that China's Communist Party may not have full control over the military.

So far, however, both China and Japan, while verbally pandering to nationalists in their respective countries, have tried to avoid going beyond diplomatic skirmishing. Having let last April's protests run for a few days, the Chinese authorities decided to rein them in, apparently concerned about the risk of a serious breakdown in relations with Japan. In recent weeks China's criticism of Japan has become more muted. Perhaps the Chinese are waiting to see what happens when Mr Koizumi steps down in September.

AP

A warm welcome from Hu (right) to Soong

One problem for China is that its most active nationalists are drawn from the very middle class upon whose support the party depends. Peter Gries of the University of Colorado says that many of those who took part in last year's protests were “savvy urban yuppies” rather than the losers from economic reform. Mr Gries describes them as “computer-literate cyber-nationalists”, well educated and exposed to world politics. The rapid spread of internet technology in China in recent years has provided new forums for nationalists to air their views. Although China's internet censors closely monitor debate on internal political issues, they give diatribes against Japan a much freer rein.

China may feel that it can afford to give the public leeway to rail against Japan because military conflict with that country is highly unlikely. The two other big preoccupations of Chinese nationalists—Taiwan and its military backer, America—are in a different category, and the government has tried much harder to prevent public sentiment from getting out of hand.

Let's be pragmatic

Indeed, in the past few months China's handling of Taiwan has shifted direction to become remarkably pragmatic. China has moved swiftly to stem a torrent of protest from Taiwan and the West against a new law adopted in March 2005 that authorised the use of force against the island should it ever try to secede from China. President Hu hosted unprecedented visits by Taiwan's opposition leaders which did much to reassure the Taiwanese public. James Soong, leader of the opposition People First Party, says that during his stay Chinese leaders officially accepted, “for the first time in history”, that Taiwan and the mainland were “equal entities”.

Kenneth Lieberthal, a former National Security Council adviser, says President Hu has apparently decided that unification with Taiwan is simply not feasible during his term of office. Although China continues to concentrate its military modernisation efforts on improving its ability to fight Taiwan and American forces that might try to protect the island, Taiwan has become much less of a sore point between China and America than it was.

Events in Taiwan in the next couple of years could make China and America more jittery again. In December next year Taiwan is due to hold elections for its legislature and in March 2008 for the presidency. Both China and America are clearly worried that President Chen will use his remaining two years in office to push for confirmation of Taiwan's independent identity. With his popularity at an all-time low, partly because of corruption cases within his party, Mr Chen may well feel inclined to use Taiwanese nationalism to shore up his popularity at home. In the past, Mr Chen has successfully exploited this sentiment to undermine his opponents, who favour closer ties, though not reunification, with the mainland.

Mr Chen has already unsettled the Chinese and Americans this year by scrapping the National Unification Council, a body that existed in name only to help Taiwan maintain the fiction that it has not abandoned the idea of rejoining China. He has also revived talk of organising a referendum, in 2007, on a new constitution for the island. China objects strenuously to this as a display of sovereign power that Taiwan in fact lacks. America has tartly reminded Mr Chen of his promises not to upset the status quo. Taiwan officials say it is China that should be blamed for having passed the anti-secession law.

The pragmatism of China's leaders could also face new challenges in Hong Kong, which in March next year will hold elections for the post of chief executive and in 2008 for the legislature. China has ruled out universal suffrage for either, and is resisting demands for a timetable to be set for introducing it.

But China has reason to feel relatively confident. In Taiwan, President Chen would need three-quarters of the members of parliament to approve any constitutional change. Given the opposition's domination of the parliament, that would make it extremely difficult for him to get enough votes for anything that would seriously anger China. And China is happy with indications that Ma Ying-jeou, the charismatic mayor of Taipei and chairman of the opposition Kuomintang party, is the likely front-runner to succeed President Chen. Mr Ma, though not keen on reunification as long as China remains a one-party dictatorship, is no advocate of independence. In Hong Kong, meanwhile, pro-democracy activists have shown no interest in street fights with the authorities.

The relationship that will dominate all others is that between China and America. In the run-up to America's presidential elections in 2008, China's rise is likely to become ever more contentious. America's trade deficit with China, which at $200 billion in 2005 was its biggest with any country, will probably remain very large, particularly in the likely event of China resisting American demands for a substantial revaluation of its currency. Workers in America's industrial mid-west already blame China for the loss of manufacturing jobs. And news that China last year became a net exporter of motor vehicles for the first time might cause further unease.

David Lampton, an American scholar, has argued that the past few years have seen a “marked paradigm shift” in American thinking about China that “threatens to substitute one flawed framework (a “weak China”) with another (a “China on steroids”). This was evident in America's horror at last year's bid by China National Offshore Oil Corporation (CNOOC), a state-owned company, for Unocal, a California-based oil and gas explorer. It would have been the biggest takeover of a foreign company by a Chinese firm, but CNOOC was forced to withdraw by wildly exaggerated fears in America of a Chinese stranglehold on vital resources.

Americans have been watching with disquiet as China has cosied up to pariah governments in Venezuela, Zimbabwe, Sudan and Iran to feed its growing hunger for resources. In Iran in particular, China's efforts to keep its economy fuelled could put it in conflict with what America regards as a vital strategic interest: keeping the Arab world free of nuclear weapons. Over the past 13 years, China has moved from being a net exporter of oil to become the world's second-biggest importer, relying on foreign sources for 40% of its demand. So Iran, which supplies 11% of China's oil imports, might need special consideration.

But China's foot-dragging on Iran could be seen as evidence of the same kind of pragmatism that has dominated the country's relationship with America for most of the period since the end of the cold war. China has advocated persisting with diplomatic efforts. Yet in January, when Russia signalled its willingness to allow Iran's nuclear programme to be referred to the United Nations Security Council, China did not attempt to block the move. China is loth to interfere in other countries' affairs because it fears that others might use such a move to justify interfering in China's. It would therefore be remarkable if the country were to vote in favour of sanctions. But it would be no less remarkable if it were to veto sanctions on its own.

China's military build-up in the next few years will alarm the Americans, particularly as it becomes clear that its forces would be able to overwhelm Taiwan and inflict enormous losses on the Americans if they chose to intervene. But there are very good reasons why China would be highly unlikely to attack Taiwan, even if it had the capability to do so. Such an attack would devastate China's relationship with the West as well as with other Asian countries, and could cripple the economic growth that the party regards as so vital. The trouble is that planners in the Pentagon cannot afford to bet on it.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

No time like the present

Mar 23rd 2006
From The Economist print edition

If China wants to reform, it should act while the economy is booming

A nation of 1.3 billion would-be consumers

CHINA is an emerging power, but it still lacks the resources and the will to exert its influence globally. This year's budget calls for an increase of nearly 14% in the foreign aid it hands out, to $1.1 billion. Last year China received its last shipment of food aid from the United Nations, and it is becoming increasingly active as an exporter of aid from South-East Asia to Africa. But at an international donors' conference in Beijing in January at which a total of $1.9 billion was pledged to deal with bird flu, China offered a mere $10m, against America's $334m and Japan's $155m. As Robert Sutter, a former American diplomat, puts it, China is not yet “ready for the prime time” with big contributions to international good causes.

In exerting “soft power”, defined by Joseph Nye of Harvard University as “the ability to get what you want through attraction rather than coercion or payments”, China hardly matters at all on the world stage. It is still struggling to define its development in a way that will keep foreigners happy. The term “peaceful rise” was fashionable for while, but then some officials felt that the word “rise” sounded too menacing. Now the term of choice is “peaceful development”.

China tries to avoid portraying itself as an economic power, preferring to be seen as just another developing country. When it puts men in space, it does so to generate pride at home. Yet when foreign donors suggest that if it can afford such things it no longer needs so much outside help, China worries that the world is turning against it.

Although its economic rise does matter hugely, it is still right to see China as a normal developing country, more concerned with its own internal problems than with trying to influence faraway countries, and profoundly insecure about the sustainability of the “miracle” that it has achieved. Jonathan Anderson of UBS argues that China's economic rise is really no miracle at all. Rather, it is a repeat (albeit concentrated on a single country) of a similar growth pattern already seen elsewhere in Asia. From 4% of world GDP today, Mr Anderson writes, China's share could well rise to 11% in 20 years' time. In 1965, Japan and other East Asian countries (excluding China) together accounted for 4% of global GDP. Twenty years later, their share had increased to 13%.

Curiously, it is often foreigners who point to China's strengths, whereas the Chinese media are full of downbeat reports. Unemployment, the growing gap between rich and poor, social unrest, crime, destruction of the environment, the health-care crisis, corruption: these are all subjects about which considerable gloom is permitted, as long as it does not involve blaming the political system itself or lead to predictions of China's collapse.

Added up, these problems could indeed be construed as serious threats to the party's survival. Not only is China's income distribution among the most unequal anywhere in the world—certainly worse than Russia's—but it has taken only a couple of decades to get to that point. Chinese people in their 40s and older began their careers at a time when China had one of the world's smallest income variations. China's situation may not be that much different from America's, but it is perceptions that count, as the United Nations Development Programme noted in a recent study. In America, less than 65% of the population think that income inequalities in their country are too wide. In China, the proportion is 95%.

Chinese officials sometimes say that income inequality in their country is close to, if not beyond, a “danger line” beyond which it poses a serious threat to social stability. Yet this overstates the problem, given that the measure is so skewed by the massive difference between urban and rural incomes. Resentment of inequality tends to be directed mainly at one's neighbours. And although inequalities within urban areas and in the countryside are big too, they can sometimes serve as a spur to greater effort—at least as long as the economy keeps growing.

As this survey has made clear, strong growth will not guarantee an easy ride. The National Development and Reform Commission, China's chief economic planning agency, has said that even with growth at 8% this year, China would be able to provide jobs for only 11m out of a total of 25m urban unemployed and new entrants to the urban workforce. That sounds worrying. But the general concensus is that growth will actually be closer to 9%, and many people find work in the grey economy and make ends meet. Unemployment is high in areas such as the rustbelt of the north-east, but not in cities of key political importance such as Beijing.

Even for many of those with legal jobs, life is far from easy. Last year the average monthly wage of migrants from the countryside—who provide the majority of manufacturing labour—was a mere 852 yuan ($105) a month. They had no health-care or pension benefits, and certainly no independent trade unions. Even so, getting a job in a town or a factory remains a better prospect for most people than sitting idle and poor in the countryside.

Corruption, though rife and egregious, has not badly blemished the image of any top leaders, apart from Chen Xitong, a former Politburo member who was sentenced to 16 years in prison in 1998 for accepting bribes. This may be thanks in part to the extreme secrecy surrounding top leaders' lives. But there is anyway little public grumbling that Politburo members are using their power to amass fortunes in foreign bank accounts. What really worries ordinary citizens are health care and education for themselves and their families, but here a restructuring of the way the government allocates money for these, and a boost in spending (which China can afford) could help a lot.

Try these

There are plenty of ways in which China could make itself fairer, freer and more open—and by doing so not only keep its people much happier but make its rise seem less unnerving to the West. A poll conducted by Ipsos-Reid last April indicated that 54% of Americans believed that the emergence of China as a superpower would be “a threat to world peace”. Nearly a third of Americans, it suggested, thought that China would “soon dominate the world”. More than 70% of Americans did not think that China would soon become a true democracy.

Some of the reforms needed could be achieved with little political change: giving farmers clear rights to their holdings; creating a social-security system that covers everyone; reducing the fiscal burden on low-level governments; and eliminating administrative barriers to internal migration. Some of these would be difficult or expensive, but they should be achievable without colossal disruption.

Some progress is being made. A revised compulsory-education law now being debated would for the first time specify central and provincial government's responsibilities for school funding. Officials say the aim is to provide free nine-year compulsory education in the countryside by the end of 2007.

Political reform is harder. For any progress to be made towards greater pluralism, sooner or later some organised opposition to the party would have to be allowed. That could cause massive social upheaval in a country undergoing such rapid change. But this is a risk that China will have to take. Waiting for its people to reach a certain level of education or income, which is often the official excuse for doing nothing, would not necessarily make the transition any easier when it eventually comes. It would, however, increase the risk of an explosion of discontent should the economy slow down. That could truly unnerve China's neighbours and the West. The best time for reform is while the economy is still booming.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Sources and acknowledgements

Mar 23rd 2006
From The Economist print edition

The author would like to thank those who generously shared their time and expertise in the preparation of this survey. In addition to those named in the text, they include: Richard Baum, Deepak Bhattasali, Cao Siyuan, Paul Cavey, Li Fan, Dang Guoying, Ding Chengri, Kenneth Davies, Elizabeth Economy, Yoichi Funabashi, Bert Hofman, Hsu Yung-ming, Hsu Szu-chien, Hu Xingdou, Takashi Inoguchi, Nicholas Lardy, Ma Jun, Yukio Okamoto, Michael Pettis, Emile Sheng, Dorothy Solinger, Song Guoqing, Akihiko Tanaka, Murray Scot Tanner, Tsai Ting-yi, Xu Zhiyong, Andrew Yang, Philip Yang and Zhu Keliang.

The views expressed in these pages are entirely the author's responsibility.

Sources:

"Chinese Nationalism in the Global Era", by Christopher R. Hughes, Routledge, 2006

"China Shakes the World: The Rise of a Hungry Nation", by James Kynge, Weidenfeld & Nicolson, 2006 (forthcoming)

"China's New Nationalism: Pride, Politics, and Diplomacy", by Peter Hays Gries, University of California Press, 2005

"China Human Development Report 2005", United Nations Development Programme

"Economic Survey of China 2005", OECD, 2005

"Asian Economic Perspectives: How to Think About China", by Jonathan Anderson, UBS Investment Research, 2006

"Will China Grow Old Before Getting Rich?", Helen Qiao, Goldman Sachs Global Economics Paper No 138, February 2006

"Popular Political Support in Urban China", by Jie Chen, Stanford University Press, 2004

"China's Rise In Asia: Promises And Perils", by Robert G. Sutter, Rowman & Littlefield Publishers, 2005

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Offer to readers

Mar 23rd 2006
From The Economist print edition

Reprints

Buy a PDF of this complete survey, including all graphics, for saving or one-click printing.

Reprints are available should you wish to order extra copies of the survey. Please send your request to the relevant region:

World-wide (excluding North America):

Rights and Syndication Department
26 Red Lion Square
London
WC1R 4HQ
United Kingdom

Tel: +44 (0)20 7576 8000
Fax: +44 (0)20 7576 8492
E-mail:rights@economist.com

North America:

Rights and Syndication Department
111 West 57th Street
New York
NY 10019
USA

Tel: +1 212 541 0532
Fax: +1 212 641 9808
E-mail:usrights@economist.com

Corporate offers and customised reprints

For corporate reprint orders of 500 or more and customisation options, please contact the Rights and Syndication Department in the relevant region:

World-wide (excluding North America):

Rights and Syndication Department
26 Red Lion Square
London
WC1R 4HQ
United Kingdom

Tel: +44 (0)20 7576 8000
Fax: +44 (0)20 7576 8492
E-mail:rights@economist.com

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Whistleblowers

Tales from the back office

Mar 23rd 2006
From The Economist print edition

It is becoming easier for employees to reveal their bosses' wrongdoings

SHERRON WATKINS, a star witness in the current trial of Kenneth Lay and Jeffrey Skilling, respectively Enron's former chairman and chief executive, is billed as a whistleblower. “Probably the closest thing to a hero to emerge from the Enron saga,” said the *Wall Street Journal*. Ms Watkins fits the public's image of what a whistleblower should be—female, feisty and ultimately vindicated, a stereotype laid down by Oscar-nominated actresses such as Julia Roberts (in “Erin Brockovich”) and Meryl Streep (in “Silkwood”), and reinforced when Ms Watkins was one of three female whistleblowers named as *Time* magazine's “Persons of the Year” in 2002.

In reality, the lives of most whistleblowers are far from glamorous. In “Whistleblowers: Broken Lives and Organisational Power”, Fred Alford, a professor at the University of Maryland, writes, “the average whistleblower of my experience is a 55-year-old nuclear engineer working behind the counter at Radio Shack. Divorced and in debt to his lawyers, he lives in a two-room rented apartment.”

Ms Watkins, at first sight a rare exception, is arguably not even a whistleblower. She made no systematic attempt to reveal wrongdoing to internal or external authorities, the defining action of a whistleblower. Her qualms were instead laid out in an internal memo that she wrote to her boss, Mr Lay, expressing a fear that the company might “implode in a wave of accounting scandals”. The memo was uncovered by an investigative committee after the company had collapsed.

Other Enron employees fit the whistleblower description rather better. In “Confessions of an Enron Executive” by Lynn Brewer, published in 2004, the author says that many of her colleagues tried to alert authorities to what was going on, including Margaret Ceconi, who blew the whistle anonymously to the Securities and Exchange Commission (SEC) in July 2001 and then publicly to members of the board in August that year. In the Houston court this month, Mr Lay's lawyer described Ms Ceconi as “a nutcake”.

It is common for organisations to retaliate against whistleblowers by questioning their sanity. The strategy, known as “nuts and sluts”, is to cast doubt on the message by casting doubt on the messenger. National Fuel Gas Company, a utility based near Buffalo in New York state, sacked Curtis Lee, a highly paid company lawyer, after he alleged that the chief executive and president had ordered him to backdate their stock options on forms submitted to the SEC in a way that made the options worth considerably more. Not only did National Fuel then sue Mr Lee (successfully) for the return of the documents that might have provided proof, but it also persuaded a local court to ban him from ever repeating the accusations. In addition, the court ruled that he undergo psychiatric treatment, a ruling that was subsequently reversed on appeal on the grounds that it was illegal, but not before Mr Lee had been “treated”. An official investigation into the matter was frustrated by the untimely death of the chairman of the company's compensation committee.

In general, American companies do not have to give employees a reason for sacking them. Some whistleblowers believe that the greatest single protection they could gain would be for it to be mandatory for firms to say why they are getting rid of an employee. Short of that, legislation is rolled out regularly with the aim of providing whistleblowers with more protection. America has had a Whistleblower Protection Act in force since 1989, and after the Enron and WorldCom disasters the Sarbanes-Oxley act added further protections to corporate whistleblowers. In particular, it ruled that all companies quoted on an American stock exchange must set up a hotline enabling whistleblowers to report anonymously.

Earlier this month another bill was introduced into the Senate designed to “improve whistleblower protections” by giving federal employees the same rights to reinstatement and damages as private-sector employees received under Sarbanes-Oxley. In particular, a whistleblower who can prove that he was unjustly sacked will be reinstated and awarded damages.

In most of Europe the legal protection given to whistleblowers is weaker than in America. In June last year, the French Data Protection Authority refused to allow the setting up of anonymous whistleblower hotlines, saying that such lines were “disproportionate to the objectives sought with the risks of slanderous denunciations”. Companies, however, have discovered an ingenious compromise: they can set up their hotlines outside France. Meanwhile, a German court has ruled that the parts of an employee code of conduct that invited employees to report misconduct to a whistleblower hotline breached German labour laws.

After reviewing hundreds of laws protecting whistleblowers, Terance Miethe, a professor of criminal justice at the University of Nevada, concluded in 1999 that “most legal protection for whistleblowers is illusory; few whistleblowers are protected from retaliatory actions because of numerous loopholes and special conditions of these laws, and the major disadvantage that individual plaintiffs have against corporate defendants.” Little has happened since to change that view—one which should give all potential whistleblowers pause.

Yet just occasionally a whistleblower triumphs against the odds. Jonathan Fishbein, a doctor who was fired by America's National Institutes of Health after reporting misconduct in federal research into viramune, an AIDS drug, was reinstated in December last year after concerted support from politicians, the media and fellow scientists. Charles Grassley, chairman of the Senate Finance Committee and a supporter of whistleblowers, said it was an example where “we can chalk one up for the good guys”. More broadly, technology may be helping the whistleblower's cause. Blogs and e-mails make it easier to raise the suspicions of regulators and to steer their enquiries.

Finally, company structures are changing, becoming more open and, via the large number of alliances and joint ventures that corporations have with each other, more open-ended. Mr Alford says gloomily that “organisations are the enemy of individual morality”. But the organisation of the future may have fewer dark corners in which to hide the wrongdoings that whistleblowers attempt to bring to light. With luck, that could result in fewer broken lives.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Ethical business

The body beautiful

Mar 23rd 2006
From The Economist print edition

Mixing money and morals

A REPUTATION for morality and high ethical standards is normally built up over the course of a lifetime. But some big companies have found a quicker route—just buy it. On March 17th L'Oréal, a French cosmetics group, offered to pay a 34% premium for Body Shop International, a high-profile British retailer of environmentally responsible toiletries that is closely identified with Anita Roddick, its do-gooding founder.

This is just the latest example of a deal in which large firms have bought smaller companies with virtuous reputations. In 2000 Unilever bought Ben & Jerry's, a wacky ice-cream-maker with a self-proclaimed “social mission”; a year later McDonald's took a 33% stake in Pret A Manger, a London-based chain of sandwich bars pledged to “no additives, no preservatives” and freshness.

The public images of firms such as McDonald's and Pret are poles apart. But Chris Bones, principal of the Henley Management College, says that mergers between the large and the virtuous only work when the cultures of the two companies are actually rather similar. Mr Bones managed mergers at Cadbury Schweppes last year when it bought Green & Black's, a chocolate-maker devoted to organic ingredients and “ethical values”. The deal, he says, “has been extremely successful”, largely because Cadbury still reflects the moral values of its Quaker founders.

The Ben & Jerry's story has been less happy. From its headquarters in Burlington, Vermont, the firm still generates the schoolboy humour for which it was famous before it became part of a global multinational. Its new flavours for 2006 include Vermonty Python, Berried Treasure and Jamaican Me Crazy. Its oh-so-wacky PR team sign themselves off as “Public Elations Multi-mediologists”, and its CEO, Walt Freese, is the “Chief Euphoria Officer”. But behind the jolly front the strains of coming into line with the deadly serious targets of a consumer-goods conglomerate are showing. Ben & Jerry's latest social audit says a survey of employees found that only 45% thought that top management was taking the company's social mission seriously.

Will the Body Shop/L'Oréal merger fare better? It has many hurdles to overcome. Although Body Shop's headquarters in Littlehampton are a mere Channel's-width away from France, French and British management teams mix, in the words of Mr Bones, “like oil and water”. L'Oréal says Body Shop will be allowed to operate as an independent unit, which sounds sensible. But will L'Oréal really be able to resist slipping its ethically challenged anti-wrinkle cream onto the shelves next to the bracing and “naturally inspired” body scrubs offered by the Body Shop?

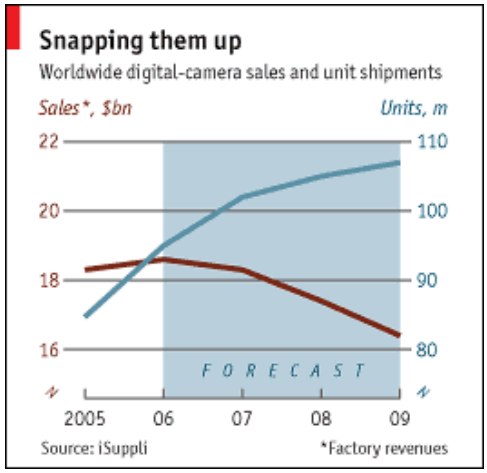
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Photography

Down with the shutters

Mar 23rd 2006
From The Economist print edition

Competition in digital photography takes another turn



AT THE end of this month, Konica Minolta will make its last camera. After more than 100 years the Japanese company, which is also the world's third-largest producer of photo film, will begin a complete withdrawal from the photography business. In future it will stick to making photocopiers, printers and medical devices. The company is the latest victim of the wholesale change brought to an entire industry by the digital camera.

Other big names in the photography business have suffered badly in the digital age. Kodak, an American group which lost almost $1.4 billion last year, is only midway through a restructuring. Like Japan's Fuji Photo Film, which after Kodak is the world's second-largest film supplier, it has seen revenues from its traditional business collapse much faster than was expected.

In little more than a decade, sales of digital cameras have soared; they have now almost completely replaced film cameras. But now even the digital camera business is maturing. After growing by 670% in 2000-05, unit sales of digital cameras are slowing. Worldwide sales are expected to rise to just over 100m a year by 2009, an increase of only 26% (see chart). At the same time, prices are tumbling. Digital cameras have rapidly become a “mature” consumer product.

Persuading people to trade up to more expensive digital cameras is one obvious response. An intense battle is looming between Canon and Sony, the two market leaders. Last year Canon captured about 18% of the worldwide digital-camera market, Sony some 15% and Kodak around 12%, according to IDC, a research firm. Sony has acquired some of Konica Minolta's photography assets and will use them this summer to launch a range of digital single-lens reflex (SLR) cameras, which use interchangeable lenses. Sony will be up against some powerful brands, including Nikon and Olympus. But Canon has the most enviable brand among serious snappers: it makes those long, white telephoto-lenses wielded by pros at sporting events. Even so, Sony will not be alone in attacking this market. Its arch-rival, Matsushita, is planning to launch a digital SLR under its Panasonic brand and South Korea's Samsung also has a model in the works.

With the top end of the market about to get crowded, profits will be harder to come by. But the market for the simple point-and-shoot cameras is likely to be just as tough. Kodak has managed to maintain market leadership over Canon and Sony in America thanks largely to its decision to specialise in easy-to-use digital cameras, often sold complete with a home photo-printer. But it too needs to persuade people to trade up. It recently launched cameras with built-in Wi-Fi to connect directly to printers or the internet.

To offset their losses, Kodak and Fuji have also expanded aggressively into digital-photo kiosks. These are proving popular with consumers, who find them an easy and cheap way of obtaining prints, says Chris Chute, an analyst with IDC. But competition here is also getting hotter. Hewlett-Packard has decided to enter the kiosk market with a rival system.

But how many people still print pictures? Billions of images never make it on to paper, but are simply e-mailed to friends or shared on websites. Yet with so many digital pictures being taken, Mr Chute believes a big market will develop for storage and archiving systems, both online and offline. No one, it seems, is really sure just how long digital pictures will survive stored on conventional hard-drives or burned onto CDs. If people want their memories to last long into the future, they may have to buy or subscribe to new products and services. And it may not be photography companies that provide them.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

China

A new train set

Mar 23rd 2006 | HONG KONG
From The Economist print edition

National pride is spurring development of China's railways

AP

Heading for an upgrade

IN THE rush to modernise its transport infrastructure, China has built scores of glossy airports and an extensive road network along its eastern seaboard. Far less attention and money has been lavished on the country's antiquated and overburdened railways, which carry a high proportion of freight and passengers.

That is changing at last. On the fringes of the annual session of the National People's Congress, China's parliament, earlier this month, Liu Zhijun, the minister for railways, announced approval for two bold and long-planned high-speed rail lines. The larger, first mooted as long ago as 1994, is a 1,320km (820 mile) link between Shanghai and Beijing. With trains along it expected to reach top speeds of 350km an hour, it should cut the travel time between the mainland's two most important cities from 13 hours to less than five—although at an eye-watering expense of some 200 billion yuan ($25 billion). The other project is a 175km connection between Shanghai and nearby Hangzhou, another big city in the booming Yangtze River Delta, that will allow speeds of up to 450km per hour and cost around 35 billion yuan.

These two lines are showpieces in a hugely ambitious official scheme to construct some 5,400km of high-speed rail track by the end of the decade, at a cost of more than 1 trillion yuan. This itself is but a part of China's plan to build and refurbish about 40,000km of its railways by 2010 in an effort to ease bottlenecks in the transport of everything from coal to soyabeans to people.

The Chinese government, however, has a second, equally important goal in mind: using the railways to display China's technological prowess in a way that it has failed to do—so far, at least—in building cars and aircraft. After two decades of deliberately importing foreign expertise in order to speed economic development, China is starting to place more emphasis on (and put more resources behind) homegrown technology. A space flight by a Chinese astronaut in 2003, followed by a second manned space mission last October are the most visible signs of this new determination to catch up with western science and engineering in everything from software and consumer electronics to semiconductors and giant engineering projects. Following an official announcement this month that China planned to build its own jumbo jets, Mr Liu said that the new high-speed rail lines will not use any foreign technology.

That is a blow for the international engineering firms that have lobbied hard to sell their high-speed trains to China, including Japan's *shinkansen*, Alstom's French TGV and the maglev (magnetic levitation) train offered by Siemens and ThyssenKrupp of Germany. Siemens is behind the 30km maglev train service that has been running between Shanghai's Pudong airport and the city since 2002. And it may win some more work since the Shanghai-Hangzhou track will also be based on maglev technology, although principally one developed by Chinese engineers over the past few years. For the other foreign companies, prospects look less promising. The longer link to Beijing will be built with different, domestically-developed technology. And, as so often in China, it will be hard to establish whether foreigners' intellectual-property rights have been infringed along the way. As Mr Liu delicately put it to the

Chinese media: “Our technology is a re-innovation on the basis of assimilating advanced technologies of foreign countries.”

At a time when economic nationalism is rising around the world, China's unwillingness to remain in thrall to foreign technology is understandable. Whether it yet has the skills to develop and commercialise its own technology in a field as complex as modern train systems is another matter. None of an earlier generation of passenger jets, today's mainland cars and the Shanghai airport maglev are financial successes. Nor will either of the new high-speed links be ready for the 2008 Olympics. While China may be getting better at running trains, they are not yet running quite on time.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Foreign investment in Russia

An enemy of the people

Mar 23rd 2006 | MOSCOW
From The Economist print edition

The sad fate of a loyal Putinista

THERE are two kinds of money in Russia. The first is the kind that boosts the overall economy and (eventually) finds its way into the pockets of ordinary people. The second is the sort that corrupt bureaucrats and their businessmen accomplices are able to purloin. As the manager of a big Russian investment fund, Bill Browder has contributed to the circulation of the first kind of money—as well as making a packet for himself, and making his rich clients even richer. But he has also interfered with the supply of the second sort of money—and been punished.

Since Vladimir Putin became Russia's president, Mr Browder has been among his most vocal cheerleaders, regularly assailing *The Economist* and others for their more sceptical stance. For instance, Mr Browder always maintained that Mikhail Khodorkovsky, the ex-oligarch now in a Siberian labour camp, had it coming. So he was puzzled when—as became known this week—last November he was turned back from Russia when he landed at a Moscow airport. It at first seemed that he had been confused with a troublemaking human-rights lawyer with a similar name; but it later transpired that the fund manager had himself been blacklisted as a threat to national security.

He has his enemies. Mr Browder's basic strategy is to talk Russia up, cleverly finding silver linings in every policy cloud. But his tactics often involve exposing corporate malfeasance in companies in which his funds have invested, in the hope of improving their behaviour and thus their share prices. Surgutneftegaz, (an oil company thought to be tight with the Kremlin), and Gazprom (a state-controlled gas leviathan) have been among his targets. Mr Browder has been sued and threatened. Hitherto, however, the state has let him be. But somebody who does not like him evidently has friends in sufficiently high places to shut him out.

The case has been taken up at lofty diplomatic levels (Mr Browder is American-born, but now has British citizenship), though, so far, to no avail. “Logic dictates that it's not in the national interest to ban the biggest investor in Russia and one of the biggest supporters of the government's policy,” says a miffed Mr Browder. Just as, in Soviet times, when prisoners were often sure that the injustices done to them would be addressed, if only they could be brought to the attention of the senior comrades, Mr Browder is hoping that intervention at the very top will allow him back to Moscow. Perhaps; but his border trouble suggests that, in Russia, the second, thievable kind of cash unfortunately remains the more important of the two.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Wine

Sweet taste of success

Mar 23rd 2006 | CAMPOBELLO DI LICATA
From The Economist print edition

Sicily's wineries find a winning strategy

OUTSIDE Campobello di Licata in Sicily, Giuseppe Milazzo's sparkling modern winery, surrounded by 70 hectares of vineyards, has been a cradle for the renaissance of Sicilian wine. At a time when other European winemakers are having to rip up vines because they cannot sell their wines, the top Sicilian vintners have been planting. Their success offers a lesson for winemakers all over the world.

Making fine wines certainly represents a change of tack for Mr Milazzo, who started his career as an agent for various arms manufacturers. Twenty years ago, he spent several months in prison on suspicion of arms trafficking, and subsequently won damages for wrongful arrest. By comparison, the wine industry is rather less alarming. But new planting for wine remains fraught with commercial risk; there is a global wine-glut and Sicily is already one of Italy's biggest wine-producing regions.

The Sicilians have sensibly been cutting production of “bulk” wines, and concentrating on exporting fine wines in bottles. Their move up-market actually began two decades ago, after a sommeliers' conference when visiting experts gave an embarrassing thumbs down to their host's wines. “The verdict was a terrible blow. Sicily had offered its best,” recalls Franco Pisa, head of Assovini Sicilia, the wineries' association. But Sicily's wineries bounced back, ditching local grape varieties to plant popular international favourites such as chardonnay and cabernet sauvignon. Now that everyone grows chardonnay and cabernet, the Sicilians have cleverly returned to their roots by making wines based on local varieties like Nero d'Avola, thus pandering to more educated and inquisitive consumers.

“Understanding trends is crucial. We cannot alter consumer taste; we must follow it,” says Diego Planeta, who has built his own wine business in southern Sicily. Last year his company sold 2.2m bottles, around half of that abroad. Mr Planeta was one of the first Sicilians to realise that lessons could be learned from the New World wineries, in particular their use of cold technology to combat Sicily's torrid summer heat. Sicilian firms had usually employed winemakers from France and northern Italy. Mr Planeta hired an expert from Australia, which has wine-growing regions with climates closer to Sicily's. Other Sicilians have followed, such as Calatrasi, a winery near Palermo.

There are some challenges, however, that only the locals are properly equipped to deal with. In the fiercely competitive global wine market, Sicilian winemakers face a unique problem that has nothing to do with soil types or air quality. Magistrates in Sicily say that the island's economy is still controlled by the Mafia. Extortion is rife, although most businessmen are understandably taciturn on this subject. Fortunately, their wines can speak for themselves.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

French economic nationalism

Colbert was here

Mar 23rd 2006 | PARIS
From The Economist print edition

The roots of "economic patriotism" go back deep into history

THE students who are marching on the streets of Paris may feel that they are re-enacting the events of 1968—or even 1789, for the truly ambitious—but in the corridors of power, the French elite are harking back to another strain in the country's rich intellectual history. Jean-Baptiste Colbert is back in fashion.

For many years, the ideas of Louis XIV's finance minister—who was convinced that international trade was a zero-sum game and pioneered state control of the economy and state intervention in industry—had been relegated to the annals of France's glorious past. But now Colbert is back with a vengeance, as Dominique de Villepin, the prime minister, promotes his notion of "economic patriotism".

Ironically, Mr de Villepin is currently being vilified by students and unionists for his proposal to liberalise French labour laws. But in the months before the student protests, his economic policies had been anything but liberal. On the contrary, hardly a week seemed to go by without Mr de Villepin announcing another measure to protect French companies from foreign ownership.

At the end of last year he introduced new legislation to protect businesses from foreign takeovers in 11 security-related sectors. He has also made it known that he has a list of ten of the 40 biggest French companies that he intends to keep under French ownership—including Danone, a yogurt maker, Carrefour, a supermarket chain, and Société Générale, a big bank. And to build up the nation's stake in French companies he is mobilising the Caisse des Dépôts et Consignations, a state-owned bank, to increase its €25 billion ($30.2 billion) investment in French equities. Meanwhile the French parliament has approved a Villepin-proposed amendment of the European Union (EU) takeover directive, making it easier to introduce "poison pill" defences to ward off hostile bids, particularly from foreigners.

"Economic patriotism", a term coined by Bernard Carayon, a French parliamentarian, has been adopted by Mr de Villepin as his new creed. In essence, it seems to be a new term for Colbertism. And unlike his labour-market reforms, it is popular. When the prime minister recently pre-empted a hostile Italian bid for Suez, a French utility, by brokering a merger between Suez and Gaz de France (GDF), a gas giant, the public cheered. According to a survey by TNS Sofres, a pollster, 69% of those surveyed approved of the government's intervention against hostile bids from abroad. The only part of the deal that the public disliked was the fact that it involved an element of privatisation.

The origins of the affair

France's love affair with state interventionism began in the 17th century, and tends to flare up when the country feels under threat. As industrialisation in the 19th century stiffened competition between European countries, the government helped to build railways and to set up banks. In the aftermath of the 1929 stockmarket crash the Popular Front, the government of Léon Blum, nationalised the defence industry, railways and the Bank of France. After nationalising further big chunks of industry and finance after the second world war—as part of a state-run effort to get France back on her feet—the government retained a strong role in business during the *trente glorieuses*, the 30 years of France's economic miracle.

The oil shocks of the 1970s contributed to the Socialists' victory at elections in 1981. They promptly engaged in a frenzy of nationalisations of banks and industrial companies. Many of these were then re-privatised at the end of the 1980s, but the state's ownership of industry remains enormous—it controls Electricité de France and GDF; the post office; the rail system, the nuclear industry; big chunks of Renault, a carmaker, Thales, a defence firm, France Telecom and much more.

The highly elitist nature of the French educational system increases the temptation to treat industry as a plaything of the state. Seven of the bosses of France's biggest companies attended the National School of Administration, or ENA—a post-graduate college so exclusive that it only admits about 100 students a year. *Enarques* populate the top ministerial offices and boardrooms. So when Mr de Villepin called a meeting at his residence to arrange the emergency merger between Suez and GDF, it may have helped matters that all three key players, Mr de Villepin

himself, along with Gérard Mestrallet, the boss of Suez and Jean-François Cirelli, the head of GDF, were *enarques*.

Indeed 1980, the year that Mr de Villepin graduated, was obviously a particularly good vintage at ENA. Among the other 100 or so graduates were Renaud Donnedieu de Vabres, a cabinet minister; François Hollande, the Socialist leader and a presidential hopeful; Ségolène Royal, Mr Hollande's partner and another potential presidential candidate; Henri de Castries, boss of AXA, an insurance giant; and Jean-Pierre Jouyet, head of Barclays France.

But before this all gets too conspiratorial, it should be acknowledged that the inbred nature of the French elite does not always lead to agreement. After the Danone episode, Mr de Castries warned that history has demonstrated that protectionism was based on an “archaic” view of the world. Laurence Parisot, head of the French employers' association, said cautiously that economic patriotism was acceptable, as long as it did not become a new Maginot line—evoking painful memories of the French military defences that the Germans waltzed around in 1940. Ernest-Antoine Seillière, head of the European employers' club, thinks his country's neo-Colbertism is mainly theatrics: “These reactions are ridiculous: nothing will stop globalisation,” he says.

But some influential French bosses do buy into Mr de Villepin's “economic patriotism”. Jean-Louis Beffa, head of Saint Gobain, which recently acquired BPB, a British plasterboard maker, after a hostile bid worth £3.6 billion, is nonetheless no defender of the free market. The Centre Courbet, a think-tank financed by Saint Gobain, regularly produces pamphlets critical of the “Anglo-Saxon” market model. Maybe Mr Beffa feels he must remain loyal to the intellectual heritage of the founder of his company: set up to replace imports of Venetian glass with home-made wares, Saint Gobain was founded in 1665 by Jean-Baptiste Colbert.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Face value

A healthier addiction

Mar 23rd 2006
From The Economist print edition

Vinod Khosla, a Silicon Valley billionaire, who wants to save the world from oil

Landov

"I HAVE a religious belief in the power of ideas propelled by entrepreneurial energy," declares Vinod Khosla. Coming from some businessmen such talk might sound self-serving or plain nutty. But Mr Khosla helped to found Sun Microsystems, a company that pioneered such essential bits of internet technology as network servers and Java, a programming language. He then made his name and his fortune as a partner at Kleiner Perkins, a Silicon Valley venture-capital firm famous for its early investments in AOL, Amazon, Compaq and Google.

His eyes have now turned towards a new target—the oil industry. He and Stephen Bing, a flamboyant Hollywood producer, are financing a campaign to get Californians to endorse clean energy in a state-wide vote next November. "Californians for Clean Energy" will need to get more than 500,000 signatures just to make it onto the ballot. If it were then passed, its effect would be to increase taxes on Californian oil production by up to $380m a year, eventually raising billions of dollars for investments in clean energy. The plan is to help California cut its oil use by one-quarter within a decade, thereby setting a powerful example for the rest of the world.

Mr Khosla is particularly enthused by "cellulosic" ethanol, a highly efficient way of making fuel from agricultural waste. President Bush touted this new technology in his recent state-of-the-union speech, suggesting that it may come to market in six years. In typically impatient form, Mr Khosla wants to halve that gestation period. Anyone who spends time with him is liable to be hit with his well-researched but mind-numbing PowerPoint presentation on ethanol—unveiled with the affection that some men reserve for pictures of their grandchildren.

Why is Mr Khosla taking on this particular crusade, when he could concentrate on the technology investments that have served him so well—or even opt for a gilded retirement? Like many very rich men, he now wants to improve the world: "Just starting another Sun doesn't do it for me any more." As an engineer turned venture capitalist, Mr Khosla has a healthy respect for the power of new technologies to create disruptive innovations. And the free marketeer in him clearly relishes the prospect of really taking on the big, rich and well-entrenched firms that dominate the oil industry.

Another part of the explanation lies in his complex relationship with India. Like several of Silicon Valley's most successful people, Mr Khosla boasts a degree from the Indian Institute of Technology. When he tried to start a project to help the mother country, he was initially frustrated by its bureaucracy and corruption. His first attempt to start a traditional top-down charity failed, so he now funds only charities embracing micro-enterprise approaches. A lesson he learned from India, he says, is that one has to think big: "Unless you influence the lives of at least a million people, it simply doesn't matter."

His plan is to use technology and entrepreneurship to tackle big social and environmental problems: "In venture capital, we fail far more often than we succeed," he says. "I've decided that I'd better focus on taking on problems that really matter, so that when I win it makes a difference to the world." He likens his need to get involved with worthy causes to a drug addiction.

It is easy to dismiss this enthusiasm as the irrelevant obsession of a rich hobbyist or the harmless utopianism of a capitalist who has made his pile. But the big oil companies are certainly not taking Mr Khosla lightly. The oil industry is funding a lavish counter-campaign to his ballot initiative called "Californians Against Higher Taxes". Perhaps the best reason to take Mr Khosla seriously is that his professional success and Republican leanings mean that he has the ears of powerful people. He has been making the rounds, from the White House and Capitol Hill to the World Economic Forum at Davos and the TED conference (a big annual gathering for top venture capitalists), banging the drum for ethanol. Before Larry Page, Google's co-founder, attended a recent TED conference in Monterey, California, he was sceptical about ethanol. After hearing Mr Khosla, he decided to help fund the cause. "When have you ever seen greens, farmers and guys like me and Larry on the same page?" demands Mr Khosla.

The power of price

So will his grand plan really work? Mr Khosla is convinced that “this fuel is greener, cheaper, more secure than gasoline—and this shift won't cost the consumer, automakers or the government anything.” There are undoubted attractions to ethanol. But making the switch will surely not be as easy or cheap as he suggests. Retail distribution is one obvious problem: fewer than a thousand petrol stations in America sell the most desirable blend of ethanol fuel today. Expanding infrastructure will cost money and take time, and the oil industry is not exactly enthusiastic. And cellulosic technology, which seems so promising today, may take much longer than expected to achieve commercial scale, or might fail altogether.

What is more, the OPEC cartel is suspected by some of engineering occasional price collapses to bankrupt investment in alternative energy. Mr Khosla concedes that after he made his ethanol pitch at this year's Davos meeting, a senior Saudi oil official sweetly reminded him that it costs less than a dollar to lift a barrel of Saudi oil out of the ground, adding: “If biofuels start to take off we will drop the price of oil.”

Anticipating this problem, Mr Khosla is lobbying politicians in Washington, DC, to impose a tax on crude oil if the price falls below $40 a barrel to safeguard investments in ethanol. Even if—surprise, surprise—Congress refuses to raise taxes, Mr Khosla insists that alternative energy must ultimately prosper. Given his record as a venture capitalist, it would be foolish to dismiss his latest bet on the future.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The logging trade

Down in the woods

Mar 23rd 2006 | SLJ2 CONCESSION, BORNEO
From The Economist print edition

In the developing world, where policing has not stopped illegal logging, environmentalists are trying a new weapon: economics

OnAsia.com

Get article background

IN A muddy clearing in the jungles of Borneo, an environmentalist surveys some fresh-cut ramin, a durable tropical timber. Huge logs, over a metre in diameter and ten metres long, lie heaped in piles around him. Dirt tracks fan out into the surrounding forest, to allow access for chainsaw crews and their vehicles. Heavy trucks, laden with wood, have dug deep ruts in the viscous, rust-red soil. It is a scene from a green nightmare, yet the activist is grinning contentedly. This is, he hopes, the sort of logging that will help to preserve the dwindling forests of Indonesia.

The key to the environmentalist's enthusiasm is the barcode that is stapled to either end of the log. For anyone with a scanner and access to the right database, this tag identifies the forest where the tree was cut, its current location and ultimate destination, its species, diameter and length, and so on. A logging firm using this tracking system can prove that its timber is both legally and sustainably harvested, and thus distinguish it from the bulk of wood and wooden goods produced in the country. That, in turn, should provide the company with easier access to western markets and win it higher prices.

In other words, the concessionaire in this instance, a firm called Sumalindo Lestari Jaya, believes that there is money to be made by following the law and taking care of the forest in which it operates—a revolutionary theory in Indonesia and much of the developing world. To prove the theory, ecologically minded firms and governments, egged on by activists, are trying to increase the financial incentives for well-behaved timber companies, and the disincentives for wayward ones.

Travelling up the Mahakam River to Sumalindo's concession, the need for new tactics in the battle against illegal logging is obvious. Indonesia's Ministry of Forestry sets a maximum harvest for the area's concessionaires, to allow the jungle to regenerate between cuttings. But the sawmills and plywood factories that line the lower reaches of the river, near the prosperous port of Samarinda, consume far more wood than the forests can legally produce. In Indonesia as a whole, processing capacity is three times greater than the officially sanctioned harvest. Foreign timber mills in places like Malaysia and China also help to swell demand for logs, although the export of raw timber from Indonesia is theoretically illegal. The result is over-cutting and steady decimation of the closest trees.

For the first 100km (60 miles) or so, the riverbanks, long ago deforested, are given over to farms and villages. Later, abandoned timber concessions begin to appear: a landing stage, a few rusting cranes, and a dirt track leading into a jungle stripped of its most valuable species and overgrown with bamboo. Over half of Indonesia's commercial timber tracts are thought to be in the same degraded state. Finally, towards the mountainous interior

of the island (the third biggest in the world), the river passes through working concessions. Mammoth trucks ferry timber from distant cutting zones to riverside staging posts. Other logs, lashed together into rafts, arrive by water down the Mahakam's many tributaries. Branches and stumps, abandoned amid the frenzied harvest, drift slowly downstream.

Still Pictures

Taking the low road

Similar scenes are being played out all across the country. According to the Food and Agriculture Organisation (FAO) of the United Nations, Indonesia is losing almost 2m hectares of forest a year—an area about the size of Wales or Massachusetts. Over the past 15 years, that amounts to one-quarter of its total forest cover. For virgin forest, the most commercially and ecologically valuable sort, the statistics are even worse: one-third of Indonesia's stock has vanished over the past 15 years, and it continues to disappear at a rate of 3% a year. In some countries, such as Nigeria and Honduras, the destruction of tropical forests is proceeding even faster, although globally, the rate is rather slower, at 0.62% a year.

Illegal logging is not the cause of all deforestation. Some trees are cut down to make way for plantations or ranching, or to provide farmland or firewood for the poor. But in most cases, farmers and developers follow in the loggers' wake, taking advantage of the roads they have built and the land they have cleared. In fact, would-be loggers sometimes contrive phoney agricultural schemes purely as an excuse to clear-cut forests. In Borneo, environmentalists are currently denouncing a dubious proposal to convert 1.8m hectares of forest into palm plantation as a logging project in disguise.

As that example suggests, illegal logging can also be difficult to define. Indonesia and other developing countries view forestry and wood-processing as important industries, and encourage their development and expansion. But most countries also have rules stipulating that these activities should be sustainable. Duly licensed concessionaires often do the most damage to the forest, by ignoring environmental rules, while paying officials to look the other way. Even unlicensed loggers usually procure paperwork from some pliant bureaucrat or other, declaring their wares to be legal. Furthermore, in Indonesia at least, the national government and local authorities often issue contradictory regulations, leaving the few logging outfits whose practices are ever challenged with plenty of wriggle room.

Whatever the legal niceties, however, there is no doubt that the costs of runaway logging are enormous. Environmentalists tend to dwell on damage to the habitats of photogenic animals such as Borneo's orang-utans. The island also boasts a greater diversity of trees than any other spot on Earth: botanists once counted 1,175 species in just 52 hectares of forest in the Malaysian bit of the island. Only 52 tree species, by contrast, are found north of the Alps in Europe. In the last decade alone, Borneo has yielded up 361 new creatures, according to the World Wide Fund for Nature. Indeed, the WWF considers the island's biodiversity so valuable that it has started a last-ditch campaign to preserve its most rugged and remote reaches from logging. It is already too late for the lowland forests: by 2010, observers predict, there will be none left.

Illegal logging also carries big costs for the human beings involved. Well-managed forests continue to provide wood, and therefore revenue, indefinitely. But those that have been overexploited, or simply carelessly run—let alone razed—will yield little or no money in the future.

Illegal logs also tend to be cheaper than legal ones, on which royalties have normally been paid. That obviously benefits consumers to a certain extent, but it also stimulates demand, and so encourages more logging. At the same time, it puts pressure on legal operations to cut their costs to compete, generally leading to lower wages and poorer working conditions for their employees. In 2004, the American Forest & Paper Association (AFPA), an industry group, calculated that illegal wood depressed world timber prices by between 7% and 16%, depending on the specific product. That competition, it argued, cost American companies alone some $460m every year.

Finally, illegal logging deprives governments of revenue from royalties. In 2002, the World Bank put the global annual cost of such evasion at $15 billion. More recently, the government of Indonesia (which has the world's third-biggest tropical forests, after Brazil and Congo, but the biggest timber trade) estimated its annual losses at around $3 billion. Given that the total value of Indonesia's legitimate exports of wood and wood products is only about $6.5 billion a year, that is a disturbingly heady sum.

Add in hidden costs such as soil erosion, the increased risk of fire (thinned-out forests let in more sunlight, and so dry out faster) and the loss of livelihoods for those who gather forest products, and the true bill becomes much bigger. The infamous South-East Asian haze of 1997 gives a sense of the scale and expense of the side effects of deforestation. The haze, which darkened skies and polluted the air across much of Indonesia, Malaysia and Singapore, rose from fires originally set by developers trying to clear forest for palm plantations in Borneo and Sumatra. The World Bank estimates that the fires released 8% of total global emissions of greenhouse gases that year. In addition, the smoke affected the health and livelihoods of some 75m people. Airports, schools and businesses closed because of poor visibility and the sheer physical discomfort of going outdoors. The incidence of respiratory ailments jumped: in a recent study, Seema Jayachandran, of the University of California, Los Angeles, calculated that the haze may have caused the deaths of as many as 16,000 infants.

In theory, the police, army and forestry officials are responsible for stopping illegal logging. Last year, amid a much-publicised crackdown, the Indonesian authorities did arrest 1,673 people for forest crimes and confiscate 155,185 cubic metres of timber, according to the police. They also seized 11 barges, 114 boats, 478 trucks and plenty of other logging equipment. But that rash of activity barely scratched the surface of the problem. In a recent report on illegal logging in Indonesia, a pressure group called the Environmental Investigation Agency (EIA) estimated that 3.6m cubic metres of wood are smuggled from Papua province alone to China each year. Many more illegal logs, of course, would have been smuggled abroad from other provinces or consumed domestically.

In part, this feeble record stems from the fact that security services are severely under-funded and under-equipped. The Indonesian authorities have hardly any serviceable ships and planes with which to patrol the seas between Papua and China. The personnel involved are also hopelessly underpaid, and therefore easily tempted. Much like the illegal drug trade, when there is so much money to be made, suppression is bound to be ineffective. The EIA calculated that wood harvested in Papua sold for around $120 per cubic metre in Indonesia, twice that in China, and as much $2,288 when made into flooring and sold in America. Junior civil servants in Indonesia, by contrast, earn $100 a month. Army generals take home perhaps $750 a month including various allowances. So the proceeds from the felling of a single tree could easily outstrip their monthly wages.

To make matters worse, most of those who are implicated in forest crimes get off scot-free, thanks to Indonesia's crooked courts. The minister of logging himself recently complained that judges were quick to convict sawmill workers, but strangely reluctant to jail their bosses. The judges' gavels, he added, were probably made of illegal timber. So far, the crackdown notwithstanding, the most senior officials to be charged with illegal logging are district chiefs and mid-ranking police officers.

To snare bigger fish, suggests David Kaimowitz of the Centre for International Forestry Research, the authorities should follow the money. After all, illegal logging, like any other big business, requires both financing before the fact and a place to park the proceeds afterwards. Indonesia's new money-laundering law explicitly mentions funds from illegal logging as ill-gotten gains to which it might be applied.

Laws in other countries contain blanket bans on transactions involving the proceeds from illegal activities. Under “know your customer” rules now in force in America and other jurisdictions, banks can be prosecuted if they do not make a reasonable effort to establish the uses and source of the funds they handle. Institutions that provide letters of credit for the export of illegal logs, for example, or finance palm plantations on illegally cleared land, might find themselves liable to prosecution.

No firms or individuals have yet been prosecuted for financial crimes related to illegal logging, although both Indonesian and German prosecutors are said to be looking into possible cases. But as Mr Kaimowitz points out, the mere possibility of legal action might cause financiers to change their ways. International banks, at any rate, are beginning to grasp the risks of relationships with poorly regulated forestry firms. In 2001, ABN AMRO, a Dutch bank, declared that it would not “finance companies or projects that are involved in, collude with or purchase timber from illegal logging operations.” More recently, HSBC and Citibank have both pledged not to lend to illegal loggers. Dozens of other big banks subscribe to the Equator Principles, which commit them to lending only to environmentally minded projects. Considering that foreign banks lent $7 billion to Indonesian forestry firms before the Asian crisis of 1997, these worthy promises could have a real impact.

Banks might also bear in mind that companies that are cavalier about their environmental responsibilities often prove lax when it comes to their fiduciary ones too. The forestry and paper industries accounted for one-quarter of the bad debts acquired by the Indonesian government when it took over failed banks in the wake of the Asian crisis. It ended up writing off roughly 70% of the value of these loans. One company alone, Asia Pulp and Paper, racked up $14 billion in bad debts. It is still bickering with its creditors to this day.

But those who want to do business only with blameless logging firms will have trouble finding any. Foreign donors

and NGOs helping to rebuild Aceh province after the devastating tsunami of 2004, for example, undertook to use only legal wood. But since Indonesian forestry laws are so laxly enforced, and paperwork so widely forged, they could not tell good wood from bad. Indeed, one of the problems hindering prosecutions of illegal loggers in Indonesia is the lack of a clear definition of legal wood. Britain's Department for International Development is currently helping the government to draft such a standard. In the meantime, the donors are importing most of their wood from Australia and New Zealand.

Much the same problem afflicts wood-buyers around the world. In 2004, Greenpeace denounced the European Commission for using illegally harvested wood from Indonesia in the refurbishment of an office building in Brussels, despite its stated policy to stick only to legitimate suppliers. According to the AFPA, some 80% of the tropical timber imported into Europe comes from illegal sources. This week, the EIA released a report accusing several big retailers in America and Britain of selling floorboards made from contraband wood.

That is where firms like Sumalindo, the eco-friendly logging outfit in Borneo, come in. In January, the Forest Stewardship Council (FSC), an independent monitoring agency, “certified” operations at the SLJ2 concession. Certification schemes, whereby outsiders inspect companies' logging practices, to make sure that they conform to certain environmental or legal standards, have been around for about 15 years. Logging companies in rich countries, dogged by poor publicity and threatened by boycotts, quickly signed up to them in the 1990s, usually at their own expense. But in the developing world, where pressure from activists and consumers often has only negligible impact, progress has been much slower.

AFP

A long haul

Since western logging firms already operate under relatively strict government scrutiny, the costs of complying with the certifiers' standards are usually not especially onerous. But in places such as Indonesia, it can be a bureaucratic nightmare just to obtain certified status. For Sumalindo, the process took five years. Moreover, unlike western logging firms, which often submit to certification for the sake of their image, those in developing countries are usually hoping to improve their margins or market access. Amir Sunarko, the boss of Sumalindo, says he is hoping to sell the firm's certified plywood at a premium to American firms with procurement policies that bar suspect wood.

The idea is not so far-fetched. The same activists that pushed western logging firms to submit to certification are now pressuring importers of tropical wood to ensure that their wares are also certified. Many big retailers, such as Home Depot, IKEA and B&Q, have promised not to sell products made with uncertified wood. Sumalindo already has one customer willing to pay above the odds for its certified wood: a garden furniture-maker called Falak Jaya, which has customers in America who demand certified goods.

At the moment, however, premiums do not seem to be high enough to spark a rush to certify. Surveys by Britain's Timber Trade Federation, an importers' club, suggest that certified tropical wood sells for only 2-3% more than the ordinary kind. That, explains John White, the head of the federation, is partly because demand remains unreliable. In fact, some buyers prefer to avoid tropical timber altogether, rather than get involved in the whole rigmarole of establishing its provenance.

Procuring a solution

That could soon change. Five EU governments, including Britain's, have adopted or are adopting procurement policies that would oblige state-funded construction projects to use certified wood. Since roughly 70% of wood is used in construction, and governments account for perhaps 40% of construction work, Mr White argues, demand for certified timber should jump. The European Commission is planning to go further. It cannot demand that all wood entering Europe be certified, since that would break the rules of the World Trade Organisation. But it is currently negotiating voluntary deals with producer countries to exclude suspect wood. It is hoping to sign the first such deal, with Ghana, later this year.

According to Heiko Liedeker of the FSC, demand for certification is already picking up in Africa, which exports mainly to Europe. The process is currently under way for forests covering over 2m hectares. Interest should climb further when the FSC introduces a watered-down form of certification designed to make life easier for timber companies in the developing world, albeit only as a step towards a full-strength version. This would do away with some onerous requirements concerning land tenure, for example, which is often murky in poorer countries. It would also ensure that wood is legal in the eyes of the local government, and does not come from a conflict zone or a virgin forest.

Advocates of certification still face plenty of obstacles. At a recent meeting of the G8 countries, America poured cold water on the idea of standardised government procurement rules, not to mention anything more than voluntary curbs on imports of suspect wood. Increasing amounts of timber pass through China for processing en route to the western world, making it easier to disguise its origins. But as Mr White puts it, “If there's a business opportunity there, people will gravitate towards it.” Or so, at any rate, Indonesia's hard-pressed environmentalists hope.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

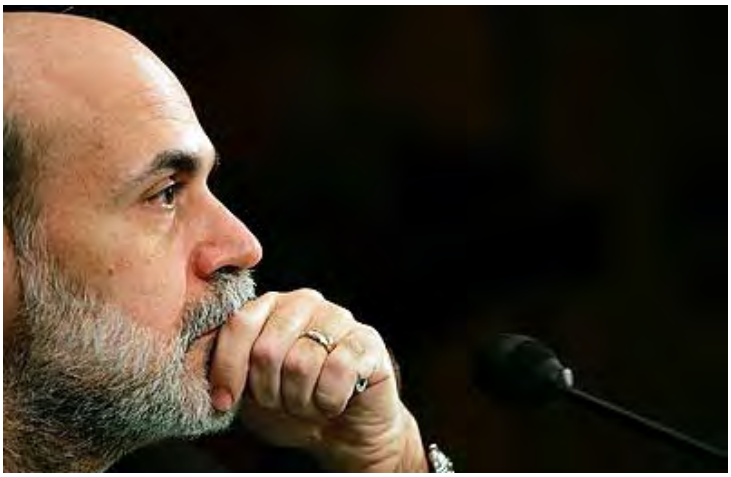
About sponsorship

Central banking (1)

Bernanke ponders his course

Mar 23rd 2006 | WASHINGTON, DC
From The Economist print edition

Getty Images



What will guide the new boss of America's Federal Reserve?

SINCE the Federal Reserve began raising interest rates in June 2004, the course of American monetary policy has been clear. From its low of 1%, the federal funds rate has been lifted, in quarter-point steps, at 14 consecutive Fed meetings. Alan Greenspan's dominance of the Fed's policy committee has been equally unambiguous. Now the way ahead is less obvious. America's central bank has a new captain, Ben Bernanke, several new crew members and an increasingly uncertain course to steer.

After all those rises, economists reckon that at 4.5% the federal funds rate is close to “neutral”—ie, neither stimulating the economy nor holding it back. Now the central bankers must decide how much higher rates should go and how to explain their thinking to financial markets. Stop too soon and inflation, already close to the top of the Fed's informal comfort zone, could become a problem. Raise rates too far or fail to make the strategy clear, and the consequences for America's unbalanced, debt-laden economy could be calamitous.

On March 27th Mr Bernanke will chair his first two-day meeting of the Federal Open Market Committee (FOMC), the central bank's rate-setting body. Financial markets believe that another quarter-point rise is almost inevitable. Less obvious is how the change in the leadership and composition of the FOMC (which consists of the Fed's board of governors and the presidents of regional Federal Reserve Banks, not all of whom vote) will influence monetary policy thereafter.

Comings and goings

Though Mr Bernanke's arrival is the most important, it is not the committee's only change. Roger Ferguson, vice-chairman since 1997, is leaving and will not take part next week. Nor will a non-voting member, Anthony Santomero, departing president of the Federal Reserve Bank of Philadelphia. Two new governors, recently appointed by George Bush, will make their debuts: Randy Kroszner, a respected economist from the University of Chicago and former member of Mr Bush's Council of Economic Advisers, and Kevin Warsh, a young White House aide.

Those prone to worry have pointed out that the board is short of expertise in monetary policy. Mr Bernanke and Don Kohn, an experienced central banker, are the only members with backgrounds in the field. Mr Kroszner is an able academic, but his specialities are banking and financial regulation. Much more alarming, Mr Warsh is seen as a shockingly lightweight appointment.

This may not matter much. Mr Bernanke has a stronger academic background than any of his predecessors. Several of the regional Fed presidents are able macroeconomists, notably Janet Yellen of the Federal Reserve Bank

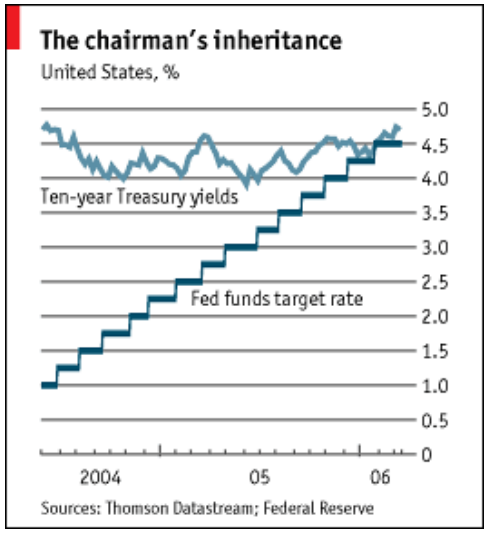
of San Francisco. Taken as a whole, the FOMC has the necessary intellectual calibre.

What may be missing, now that Messrs Greenspan and Ferguson have gone, is experience of managing crises. Mr Ferguson was the man in charge on September 11th, 2001. Now Mr Kohn and Tim Geithner, president of the Federal Reserve Bank of New York and a Treasury official in the Clinton administration, are the only veterans of turbulent times. But maybe not too much should be made even of this. Mr Greenspan, after all, made his name as a steady man in a crisis for his handling of the 1987 stockmarket crash, shortly after he took the chair. If push comes to shove, Mr Bernanke could win a similar reputation.

Luckily, there is no crisis in close sight. The Fed's main task is to recalibrate its monetary strategy. Mr Bernanke is known to favour an explicit inflation target, an idea embraced by other central banks but not by the Fed, so there has been plenty of speculation about how fast he might move in that direction. Not very, is the likely answer. Mr Bernanke has made clear he seeks no sudden change in the Fed's operations. His tactic seems to be to suggest to Americans the virtues of such a target, meanwhile nudging the FOMC into gradual reform, such as publishing more frequent policy forecasts and fuller statements explaining interest-rate policy.

Good communication will be a priority. In recent weeks the central bankers have said that their decisions have become more “data dependent” now that interest rates are near neutral. What does that mean? Mr Bernanke's comments suggest that the Fed will be looking at a wide variety of economic indicators to work out how they might affect not only the next interest-rate decision move, but also the central bank's longer-term forecasts.

That might seem obvious. The trouble is that America's economy is sending conflicting signals. Some numbers, such as the low saving rate and the colossal current-account deficit, suggest that the economy's course is unsustainable. Despite the Fed's rate rises, overall financial conditions have remained loose: bond yields, in particular, have stayed unusually low, though they have picked up lately (see chart). The latest statistics say that while the economy is, if anything, proving stronger than expected, inflation remains surprisingly tame.



Although the housing market may be slowing, consumption is booming and companies' investment has picked up. Although unemployment is low (the rate is 4.8%) and oil prices are high, inflationary pressures are modest. In the last three months of 2005, core consumer-price inflation (ie, excluding food and energy) was running at an annualised 2.6%. In the three months to February 2006 it fell to 2%.

Lately FOMC members have sounded uncertain about what such oddities —especially low long-term interest rates—might mean for policy. In a speech on March 20th, Mr Bernanke analysed reasons why yields might be so thin. Different causes, he said, have different implications for the Fed. If yields are low because investors demand less compensation for holding long-term assets, then financial conditions have become looser and the central bank, other things being equal, needs to continue tightening. But if yields are low because of an increase in global saving relative to opportunities for investment, the central bank would need to tighten less.

For now, the FOMC thinks that the risk of inflation outweighs that of weaker overall demand. Although Mr Bernanke admits that the housing market is a risk, he seems less concerned about the effect of lower house prices than his predecessor was. Last year Mr Greenspan gave several warnings that a slowdown in the housing market could hurt consumption. Mr Bernanke appears to think mortgage-equity withdrawal less important in boosting spending than Mr Greenspan did, and to believe that solid wage and job growth are now supporting consumption. He seems confident that even if interest rates continue to rise, the effect on households' mortgage costs will be gradual.

That said, the central bankers' worries about inflation have been eased by the failure of high oil prices to stoke core inflation. The bankers also seem sanguine about the tightness of the labour market. Profit margins are fat, so firms should be able to absorb higher wages without raising prices.

What all this means for short-term interest rates is unclear. The markets expect that rates will rise once more after next week and then stay at 5% for a while. But if the economy is as resilient to weaker house prices as Mr Bernanke seems to believe, rates might have to go up again. If spending is dragged lower, rates might be too. Whichever happens, Mr Bernanke must pick his course with care.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Central banking (2)

The Issing link

Mar 23rd 2006 | FRANKFURT
From The Economist print edition

Money still makes the world go around. For some policymakers, anyway

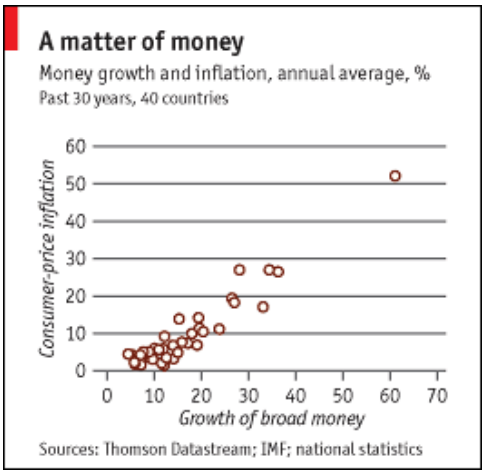
TWO events in the past week highlight the huge divide in monetary policy thinking between Europe and America. On March 16th and 17th, a conference was held in Frankfurt to honour Otmar Issing, chief economist of the European Central Bank (ECB), who retires in May. Most participants agreed that central banks still need to watch the growth of the money supply. A week later, America's Federal Reserve stopped publishing M3, its broadest measure of money, claiming that it provided no useful information. Who is right?

Mr Issing was the architect of the ECB's monetary-policy strategy. He built it using a design taken from Germany's Bundesbank, where he was previously the chief economist. He holds two controversial beliefs that challenge prevailing monetary orthodoxy. First, he thinks that central banks must always keep a close eye on money-supply growth. Second, central banks sometimes need to lean against asset-price bubbles.

Consider the role of money first. Ask non-economists, "What is economics?" and they will often reply that it is "all about money". Yet the odd thing is that the standard academic models used by most economists ignore money altogether. Inflation instead depends simply on the amount of spare capacity in the economy.

Nor does the money supply play any role in monetary policy in most countries, notably America. Alan Greenspan's last ten speeches as chairman of the Federal Reserve contained not a single use of the word "money".

Yet Milton Friedman's dictum that "inflation is always and everywhere a monetary phenomenon" is still borne out by the facts. The chart plots the rate of inflation and broad money-supply growth in 40 economies over the past 30 years. In the long run, countries with faster monetary growth have experienced higher inflation. So why are central banks (except the ECB) paying so little attention to money?



The problem is that over short periods the link between the money supply and inflation is fickle, because the demand for money moves unpredictably. The Bank of England's early days provide a good example. Uncertainty over exactly when ships laden with valuable commodities would arrive in London could cause unexpected shifts in the demand for money and credit. The uncertainty was caused by many factors, notably changes in the direction and the speed of the wind as ships came up the river Thames. The bank's Court Room therefore had a weather vane (still there today) to provide a surprisingly accurate prediction of shifts in the demand for money. Sadly, no such gauge exists today. Financial liberalisation and innovation have also distorted measures of money, making monetary targeting—all the rage in the early 1980s—unworkable.

But it would be foolish to conclude that money does not matter. Throughout history, rapid money growth has almost always been followed by rising inflation or asset-price bubbles. This is why Mr Issing, virtually alone among central bankers, has continued to fly the monetarist flag.

The ECB's monetary-policy strategy has two pillars: an economic pillar, which uses a wide range of indicators to gauge short-term inflation risks, and a monetary pillar as a check on medium- to long-run risks. The monetary pillar has attracted much criticism from outside the ECB; it is often dismissed as redundant, if not confusing. It was originally intended to guard against medium-term inflation risks. More recently, Mr Issing has justified the pillar as a defence against asset bubbles, which are always accompanied by monetary excess.

Mr Issing's model is at last starting to win friends abroad. Julian Callow, an economist at Barclays Capital, sees strong parallels between the Bank of Japan's (BoJ) new monetary policy framework and that of the ECB. The BoJ has said that it will track the economy from two perspectives: price stability and growth one to two years into the future; and a broader assessment of medium- and longer-term risks, which is likely to include the growth of asset prices and credit. In his time at the podium at last week's conference, Kazumasa Iwata, deputy governor of the

BoJ, seemed to confirm that the bank's new framework owed much to Mr Issing's legacy.

Pick your monetary metaphor

Unlike some central bankers, Mr Issing loves to be challenged, so he invited Don Kohn, a governor of the Fed, to tackle the ECB view that a central bank should sometimes “lean against the wind” to prevent an asset bubble inflating, by tightening policy by more than inflation alone would require. Mr Kohn argued the usual Fed line: because of huge uncertainties, it is too risky to respond to bubbles and therefore it is safer to “mop up” by easing policy after a bubble bursts. He tried to present the Fed's approach to asset prices as the neutral one, ie, less activist than the ECB's. But that is misleading. There is no such thing as “doing nothing”. Under the Fed's approach, unfettered liquidity sustains a bubble.

This link between money and asset prices is why the ECB'S twin-pillar framework may be one of the best ways for central banks to deal with asset prices. A growing body of academic evidence, most notably from economists at the Bank for International Settlements, suggests that monetary aggregates do contain useful information. Rapid growth in the money supply can often signal the build-up of unsustainable financial imbalances, as well as incipient inflation.

Charles Goodhart, a former member of the Bank of England's Monetary Policy Committee, mused in his speech to the conference that it would be deeply ironic if Mr Issing's departure coincided with a demonstration of the underlying worth of the monetary pillar. In other words, this may be precisely the wrong time to dismiss monetary aggregates: in these days of asset-price booms and imbalances, their informational content may be becoming more, not less, valuable. Will Mr Bernanke please take note?

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Quattrone case, cont'd

Frank's new friends

Mar 23rd 2006 | NEW YORK
From The Economist print edition

Appeal-court judges grant Frank Quattrone another retrial

UNTIL this week, Frank Quattrone was the most senior banker to be convicted in connection with Wall Street's greatest payday ever, the dotcom bubble. One day he may regain that title. But for now, the former head of the technology group at Credit Suisse First Boston (CSFB) must be presumed innocent, after an appeal court decided on March 20th to grant him a fresh trial on charges of obstruction of justice and witness tampering. The new trial will be Mr Quattrone's third on the same charges. He was convicted in 2004 after the second. The first ended in a mistrial in October 2003 after the jury had failed to agree on a verdict.

In 1995 Mr Quattrone, then at Morgan Stanley, was the banker behind the first hot internet flotation, the initial public offering (IPO) of shares in Netscape. At Deutsche Morgan Grenfell, he took Amazon public. In 1998-2000, his CSFB team led 138 high-tech IPOs, as many as Goldman Sachs and Morgan Stanley combined. Part of Mr Quattrone's appeal to bosses planning to take their companies public was the so-called “Friends of Frank” accounts, reportedly held by some 300 favourites who thereby gained preferential allocations of shares in other hot IPOs.

After the dotcom bubble burst in 2000, prosecutors initially hoped to try Mr Quattrone in connection with these accounts, on the assumption of some illegal *quid pro quo*. In the end, they charged him with obstructing justice, after they found an e-mail forwarded by Mr Quattrone in December 2000 advising his team to “catch up on file cleaning” at a time when, as Mr Quattrone allegedly knew, investigations were starting into CSFB's IPO practices.

When convicted, he seemed to have much in common with Martha Stewart, who was jailed for lying to investigators about something which turned out not to be illegal (in the domestic diva's case, a share sale). No one is thought to have done anything wrong as a result of Mr Quattrone's e-mail. This week's ruling is more reminiscent of the case of Arthur Andersen, an accounting firm which went bust after it was convicted in June 2002 for obstructing justice, having shredded Enron-related documents. Last May America's Supreme Court overturned the verdict, on the grounds that the judge gave the wrong instructions to the jury—the same reason given by the appeal court this week.

Those who think the government has been too aggressive in pursuing those said to be responsible for America's turn-of-the-century corporate excesses are claiming Mr Quattrone as their new hero. Less happily for him, the appeal court concluded that enough evidence had been presented at the second trial to make a guilty verdict reasonable (although, in a new trial, by no means inevitable). It also ruled that prosecutors had been within their rights in drawing the jury's attention to Mr Quattrone's huge pay-packet.

At least Mr Quattrone has yet to see the inside of a prison cell: his now quashed 18-month sentence had been suspended pending his appeal. He shares his good fortune with another fallen idol of the bubble era, ex-WorldCom boss Bernie Ebbers, who remains at liberty as he challenges a 25-year jail sentence. Dennis Kozlowski, once of Tyco, is less lucky. He is appealing against his 25-year term from a maximum-security prison in Fishkill, New York, his judge not being as friendly as Frank's.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The rupee

Fear of freedom

Mar 23rd 2006 | DELHI
From The Economist print edition

Capital controls are to go, as India's reformers tackle unfinished business

AFP

Free the rupee

IN A difficult political environment, Manmohan Singh, India's prime minister, has a knack for pursuing reform by stealth. An important proposal was announced on March 18th not in parliament but in Mumbai at a humdrum book launch of the third volume of a history of the Reserve Bank of India (RBI), the central bank. Mr Singh said he had asked the RBI to "revisit" the issue of full convertibility of the rupee. Suspicions that this was to be a leisurely academic exercise were dispelled two days later, when the RBI announced it had set up a committee to produce, by July 31st, a "roadmap" for lifting capital controls.

As finance minister in the early 1990s, Mr Singh did much to open India's economy to the world, and the rupee became convertible on the current account—ie, for trade. But controls have stayed on both the outflow of capital—the purchase of foreign assets—and some inflows, such as foreign-currency borrowing from banks at commercial terms. Fluctuations in the exchange rate, meanwhile, have been smoothed by the RBI's intervention.

Reformers have always seen this as an unsatisfactory halfway house. As long ago as 1997, Palaniappan Chidambaram, then, as now, the finance minister, called capital-account convertibility "a cherished goal". On his request, the RBI appointed a panel of experts to point a way there. That body has now been reconvened under the same chairman, with most of the same members and much the same mandate.

The 80-page report it produced in 1997 argued that a more open capital account would bring great benefits—notably, faster growth through easier access to capital. A convertible rupee is also essential if Mumbai is to fulfil Mr Singh's ambitions for it as a regional financial centre. As Surjit Bhalla, an economist, hedge-fund manager and member of both panels, puts it: "We need it for the Indians, not the foreigners."

The 1997 panel proposed a phased lifting of controls over three years. Its report, however, appeared at an inauspicious moment, in June. The Asian financial crisis broke out on July 1st, with the devaluation of the Thai baht, and condemned it to gather dust. India weathered that financial storm largely unscathed, for which its capital controls were given some credit.

The shelved report suggested some preconditions to liberalisation: that an inflation target be set; that the government's big fiscal deficit be contained; and that the financial system be strengthened. It also called for monitoring of India's balance of payments and the level of its foreign-exchange reserves.

On most of these measures, India is in a much stronger position now than it was then. But there is some concern about the current account, which after three years of modest surplus is now in deficit—by as much as 4.6% of GDP in the third quarter of last year. In its annual report on the Indian economy in January, the IMF noted that this was making India more dependent on volatile inflows of portfolio investment, and so "more susceptible to reversals".

The fund also noted, however, that India's large reserves of foreign exchange (now about $137 billion) exceed by about $50 billion the sum of bank deposits held by non-resident Indians, foreign portfolio investment in India and short-term foreign debt. The risk of a crisis seems small.

That has not stopped an outcry from the Communist parties, whose votes Mr Singh needs for a majority in parliament, but which argue that liberalisation will be an IMF-decreed disaster. Mr Chidambaram says he did not announce it in his budget speech last month so as not to deflect attention from his important fiscal measures. That many parliamentarians oppose it is another plausible explanation.

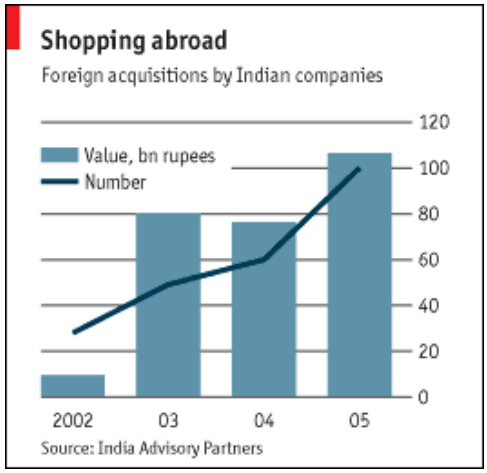
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Investment banks in India

Gold rush

Mar 23rd 2006 | MUMBAI
From The Economist print edition

India's financial boom is winning the attention of Wall Street banks



EAGER to buy a share of India's economic promise, Wall Street's investment banks are shrugging off local partners and taking full charge of their Indian businesses. In December Merrill Lynch decided to take control of its Indian venture. Now Goldman Sachs says it will build a wholly owned onshore investment bank and securities firm, bringing to an end a decade-long partnership with Kotak, an Indian group.

Goldman will sell its 25% stakes in two ventures to Kotak for 3.3 billion rupees ($75m) and Merrill will pay about $500m to increase its ownership in DSP Merrill Lynch from 40% to 90%. Now attention has switched to JM Morgan Stanley, last of the three joint ventures that once dominated the market. Some think that the recent departure of a top executive, to set up the local operations of Credit Suisse First Boston, could be a sign that it too will unravel: similar departures proved to be harbingers at Kotak and DSP Merrill Lynch. Other banks seeking a stronger presence in India include Lehman Brothers, UBS, CLSA (part of France's Crédit Agricole) and Barclays, which said this week that it was putting $150m into its Indian investment-banking business, doubling its investment.

One lure is India's red-hot stockmarket. Foreign institutions have been piling in, and investment banks' local broking arms made around $1 billion last year from these investors' trades. The main attraction, however, is Indian companies' hunger for capital—and the ability of local capital markets to satisfy it. Several billion-dollar share offerings have been received enthusiastically. Last year saw at least three corporate-finance deals worth $1 billion-plus, topped by Vodafone's payment of 67 billion rupees for a 10% stake in Bharti Tele-Ventures, an Indian mobile-telephone company.

Indian companies are also increasingly looking abroad to raise capital and buy companies, says Rajeev Gupta, who is in charge of buy-outs at Carlyle India Advisors, a private-equity firm. The number of foreign purchases by Indian firms has increased fourfold in four years, according to India Advisory Partners, which tracks mergers and acquisitions (see chart above). If the government's idea of making the rupee fully convertible becomes reality (see article), it will create opportunities for larger debt-financed buy-outs by Indian companies, says Venkat Anantharaman, a senior corporate-finance banker at Standard Chartered.

Bankers doubt, however, that the Indian market is quite ready to fulfil the Wall Street banks' expectations. Competition is fierce, with at least a dozen foreign banks, as well as locals such as ICICI Securities and Enam, jostling for mandates that last year yielded total fees of only around $300m. Book-running fees on local share offerings are low: even billion-dollar mandates fetch less than 2%, says Amit Chandra, co-head of DSP Merrill Lynch. (On Wall Street, banks get much more.) Small banks tend to undercut fees on large mandates to “choke the revenues” of big banks, as another banker puts it.

Concerns over the quality of initial public offerings are already being voiced and sky-high share prices are giving some buyers pause for thought. Privatisation sales have all but stalled and restrictions on foreign ownership of banks and insurers pose other hurdles. A downturn in the stockmarket could unsettle everyone. “Too much competition inflicts short-term pain and a downturn will make it interesting,” says Merrill's Mr Chandra. There will not be enough money to go around.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

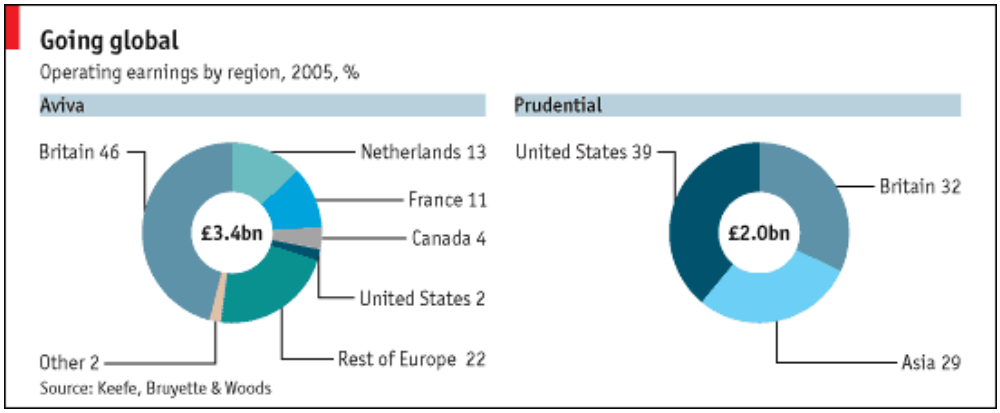
PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Insurance

The pursuit of Prudence

Mar 23rd 2006
From The Economist print edition



The proposed union of Britain's two top insurers is no mere local matter

A COUPLE of months ago Richard Harvey, the chief executive of Aviva, Britain's biggest insurance company, hosted a dinner in London to mark the Chinese new year, with a dish from each city in which Aviva has an office. Guests received horoscopes for the year ahead. Mr Harvey seems to prefer not to leave his future to fate. Late last week Aviva made an all-share offer for Prudential, Britain's next-largest insurer.

Aviva is offering 82 of its own shares for every 100 of Prudential's. At Aviva's closing price on March 22nd, this equates to £6.72 ($11.74) per share, or £16.3 billion. Prudential rejected the bid. But this week Mr Harvey took his case directly to the Pru's shareholders (some of whom have stakes in both companies) in an effort to win support. The expectation of a higher offer, or even a bidding war, drove up insurance shares.

Whether the bid succeeds or not, what looks on the surface like an all-British affair is really an attempt to bring two international businesses together. Aviva, which has an international network centred mainly on Europe (see chart), is bidding for a company that could satisfy its ambitions farther afield. Prudential's business in China is considered particularly attractive, although it also has a solid presence in America, through Jackson National. In Britain, Aviva could probably wring cost savings from Prudential's less stellar business, broadening its own product range and distribution at the same time. Both companies have fund-management arms.

In fact, most of Europe's big insurers are increasingly looking abroad for chances to grow. They are paying special attention to America and Asia, although foreign insurers are still subject to fairly tight restrictions in markets with the biggest potential, notably China and India.

There are several reasons for this push. One is that big insurers have growing piles of excess capital available for spending on acquisitions. In Britain, the market is both mature and competitive. In western Europe, the biggest players are bumping up against each other. Looming regulatory changes—under new rules known as Solvency 2—will favour bigger players with more diversified portfolios of risks.

It is by no means sure that Mr Harvey will face a rival bidder. France's AXA has a healthy balance sheet and Henri de Castries, its chief executive, wants to extend its international reach, doubling sales and tripling profits by 2012. Although Prudential's Asian and American operations may be enticing, the British company might look rather expensive to a firm used to seeking out bargains. Allianz, a German giant, has bought European firms before and enjoyed record profits last year. But it is preoccupied now, restructuring its business while trying to maintain the loyalty of its sales agents.

Outside Europe, American International Group, America's largest insurer and the leading foreign player in China, is still dealing with both a settlement with American regulators and payouts from last year's hurricane damage. It is unlikely to have the appetite for an acquisition just yet. Indeed, American insurers have generally been less than keen on buying European companies: from across the Atlantic, Europe looks crowded and expensive. Recent reports of a bid by St Paul Travelers, one of America's top insurers, for Switzerland's Zurich Financial Services have

been denied by the American firm.

Analysts say that insurance companies are likely to choose their merger partners more carefully than they have in previous takeover waves. Shareholders, they argue, have become more discriminating. As Prudential's shareholders ponder Aviva's advance, they will surely ask whether Mr Harvey is offering them enough for the Pru's interest in a promising Asian market. “The China opportunity figures in this in a major way,” says Bob Yates, an analyst at Fox-Pitt, Kelton, an investment bank. “What will it take to tempt them?”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economics focus

Push and pull

Mar 23rd 2006
From The Economist print edition

Should the G8 promise to buy vaccines that have yet to be invented?

JESUIT missionaries in Peru stumbled across the first effective treatment for malaria: an alkaloid called quinine, extracted from the bark of the cinchona tree. Unfortunately, a vaccine for this resilient disease, or other big killers such as tuberculosis (TB) and AIDS, does not grow on trees. Inventing one, and bringing it to market, is a risky and costly undertaking. And the people in direst need of such vaccines—the poor—lack the purchasing power to make them worth a company's while.

Michael Kremer, an economist at Harvard University, argues that donors—ie, rich countries' governments—could engineer a market where none yet exists*. They should make a legally binding commitment to buy a vaccine, if and when one is invented. If credible, such a promise would create an incentive for profit-seeking companies to find, test and make life-saving jabs or pills. Whereas today public money "pushes" research on neglected diseases, under his proposal the promise of money tomorrow would "pull" research along.

This elegant notion, often called an "advance purchase commitment" (APC), has migrated with unusual speed from Mr Kremer's blackboard to the communiqués of the powerful. Next month, the finance ministers of the G8 countries will settle on one or two proposals in this spirit. As well as the toughest nuts—vaccines for AIDS, malaria and TB—three softer targets are also vying for the G8's attention: rotavirus (which causes diarrhoea in children), human papillomavirus (a cause of cervical cancer), and pneumococcus (a bacterium that causes pneumonia).

But even as it wins converts, the APC idea is also collecting critics. None is more dogged than Andrew Farlow, an economist at Oxford University and author of a sprawling critique† of Mr Kremer's big idea and its application to malaria in particular. APCs, he says, are a "policy boil" that needs to be lanced.

There is, Mr Farlow points out, no such thing as "a" malaria vaccine. The first vaccine to market may not be the best possible. The earliest polio shot, for example, was superseded by an oral vaccine, which was easier to administer and lasted longer. From the outset, the G8 will have to set out the traits of a vaccine it would be willing to buy: how effective it must be; how long it should last; the maximum number of doses it should require. Its thorny task is to decide what would be desirable, at what price, long before anyone knows what is feasible.

However the terms are set, Mr Farlow argues, the G8 pledge will at best motivate firms to hit this mark, but not surpass it. Firms are, after all, competing for a limited pot of money. (Mr Kremer and his collaborators suggest it should be about $3 billion for a malaria, AIDS or TB vaccine, which is about the value of the market for a new drug in the rich world.) A company that comes to market second, with a later, better vaccine may find the pot already emptied by its swifter rival. If companies anticipate this danger, they will lower their sights, settling for a vaccine that just clears the bar set by the G8 donors.

To this objection, the advocates of pull-funding have at least two responses. First, in the face of a disease such as malaria, which kills up to 2.7m people a year, speed is itself a virtue, for which some sacrifice in quality may be worthwhile. Second, in its current incarnation, the APC creates some room for later vaccines to enter the market. Money will not be showered on a company the moment it crosses the finish line, but will be paid out a little at a time. In one scenario, the final customers for vaccines would set the pace. For example, the Kenyan health ministry would decide whether to buy a company's vaccine, for $1 per dose, and the company would then receive a "top-up" payment of $14 from the G8. If the pot (including the Kenyan co-payments) contained $3 billion, it would be drained only after 200m shots had been sold. This, advocates hope, will give a second-generation vaccine time to steal the market from its forerunners.

Unfortunately, this set-up creates problems of its own. Corruption is one danger. If every dollar that a health ministry spends on a given vaccine is worth another $14 to the company supplying it, an unscrupulous firm might go to illegal lengths to attract the ministry's custom.

A cure or a placebo?

What if companies fail to bite at the carrot the G8 dangles before them, or fall short of a vaccine donors are willing to buy? Well then, argues Mr Kremer, donors have lost nothing. If his scheme fails, the public purse has lost hardly a cent. If it succeeds, then every dollar spent is eminently worthwhile. This, needless to say, is a big part of his scheme's appeal to politicians.

But Mr Farlow doubts that a G8 promise would be credible unless funds were set aside in advance—money he would rather were used elsewhere. There is much else to spend it on. By one count, more than 25 malaria vaccines are currently in or near clinical trials, pushed by public money and philanthropic generosity. Several vaccines, for example against hepatitis B, have already been invented, but fail to reach all the poor.

APCs should not stop governments providing a push wherever it is needed, Mr Kremer insists. But will governments themselves hear him? Critics argue that even if his scheme makes no claim on public funds today, it has still made a big demand on political attention, diverting it from other ends. Mr Kremer sincerely hopes APCs will help provide the world's poor with much-needed vaccines. It might; but despite his best intentions it might instead provide politicians with a prophylactic against other pressing demands for their help.

---

* For example, “Making Markets for Vaccines”. Available at www.cgdev.org/content/publications/detail/2869/

† “The Science, Economics and Politics of Malaria Vaccine Policy”. Available at www.economics.ox.ac.uk/members/andrew.farlow

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The scientific method

Computing the future

Mar 23rd 2006
From The Economist print edition

The practice of science may be undergoing yet another revolution

Superstock

WHAT makes a scientific revolution? Thomas Kuhn famously described it as a “paradigm shift”—the change that takes place when one idea is overtaken by another, usually through the replacement over time of the generation of scientists who adhered to an old idea with another that cleaves to a new one. These revolutions can be triggered by technological breakthroughs, such as the construction of the first telescope (which overthrew the Aristotelian idea that heavenly bodies are perfect and unchanging) and by conceptual breakthroughs such as the invention of calculus (which allowed the laws of motion to be formulated). This week, a group of computer scientists claimed that developments in their subject will trigger a scientific revolution of similar proportions in the next 15 years.

That claim is not being made lightly. Some 34 of the world's leading biologists, physicists, chemists, Earth scientists and computer scientists, led by Stephen Emmott, of Microsoft Research in Cambridge, Britain, have spent the past eight months trying to understand how future developments in computing science might influence science as a whole. They have concluded, in a report called “Towards 2020 Science”, that computing no longer merely helps scientists with their work. Instead, its concepts, tools and theorems have become integrated into the fabric of science itself. Indeed, computer science produces “an orderly, formal framework and exploratory apparatus for other sciences,” according to George Djorgovski, an astrophysicist at the California Institute of Technology.

There is no doubt that computing has become increasingly important to science over the years. The volume of data produced doubles every year, according to Alexander Szalay, another astrophysicist, who works at Johns Hopkins University in Baltimore. Particle-physics experiments are particularly notorious in this respect. The next big physics experiment will be the Large Hadron Collider currently being built at CERN, a particle-physics laboratory in Geneva. It is expected to produce 800m collisions a second when it starts operations next year. This will result in a data flow of 1 gigabyte per second, enough to fill a DVD every five seconds. All this information must be transmitted from CERN to laboratories around the world for analysis. The computer science being put in place to deal with this and similar phenomena forms the technological aspect of the predicted scientific revolution.

Such solutions, however, are merely an extension of the existing paradigm of collecting and ordering data by whatever technological means are available, but leaving the value-added stuff of interpretation to the human brain. What really interested Dr Emmott's team was whether computers could participate meaningfully in this process, too. That truly would be a paradigm shift in scientific method.

And computer science does, indeed, seem to be developing a role not only in handling data, but also in analysing and interpreting them. For example, devices such as “data cubes” organise information as a collection of independent variables (such as the charges and energies of particles involved in collisions) and their dependent measurements (where and when the collisions took place). This saves physicists a lot of work in deciphering the links between, say, the time elapsed since the initial collision and the types of particle existing at that moment. Meanwhile, in meteorology and epidemiology, computer science is being used to develop models of climate change

and the spread of diseases including bird flu, SARS (severe acute respiratory syndrome) and malaria.

Roboboffin

Stephen Muggleton, the head of computational bio-informatics at Imperial College, London, has, meanwhile, taken the involvement of computers with data handling one step further. He argues they will soon play a role in formulating scientific hypotheses and designing and running experiments to test them. The data deluge is such that human beings can no longer be expected to spot patterns in the data. Nor can they grasp the size and complexity of one database and see how it relates to another. Computers—he dubs them “robot scientists”—can help by learning how to do the job. A couple of years ago, for example, a team led by Ross King of the University of Wales, Aberystwyth, demonstrated that a learning machine performed better than humans at selecting experiments that would discriminate between hypotheses about the genetics of yeast.

And it is in biology that computing science is likely to have its greatest impact. The report argues that cells and complex cellular systems can be seen as information-processing systems, so there is a natural fit between them and computational logic circuits. That could lead to new developments in biology, biotechnology and medicine, as well as in computer science.

It is, perhaps, hardly unexpected that if 34 scientists with an interest in computing are asked to comment on the importance of computer science, they will find that it is, indeed, “The Future”. Even so, the team's case is a respectable one. Indeed, this week's issue of *Nature* has given it “earthquake coverage”—devoting several pages to news and comment about the report. And Microsoft Research Cambridge also announced that it will provide €2.5m ($3m) to support research that addresses policy areas outlined by the report, which include a reform of the education system and the creation of new kinds of research institutes. This is, admittedly, a small sum. If Microsoft wants the world to take its claims—and those of the scientists it commissioned to think about such things—seriously, then it should put more money where its mouth is. Otherwise the old guard might hang around rather longer than expected.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com SCIENCE & TECHNOLOGY
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Cosmology

MAP-ping the universe

Mar 23rd 2006
From The Economist print edition

Research from the beginning of time

IT IS always nice to be proved right, and that is the happy position in which the controllers of WMAP, an orbiting observatory designed to look at the beginning of the universe, find themselves. Their latest tranche of data on the universal microwave background left over from the Big Bang (WMAP stands for Wilkinson Microwave Anisotropy Probe) confirms the probe's initial observations that space itself underwent an enormous “cosmic inflation” about a trillionth of a second after the beginning of time.

It is possible to tell this from slight variations in the intensity of the microwave background. These are caused by the peaks and troughs of sound waves that echoed through the early universe, and which themselves echo tiny irregularities in the distribution of matter that were “frozen” into the universal fabric by the sudden expansion of cosmic inflation.

The data, which have been submitted for publication in the *Astrophysical Journal*, also confirm that the universe is not what it seems to human senses. Previous observations suggested that matter of the sort that you can drop on your foot is a mere 4% of the total. The bulk of the universe—some 74% of it—is made of stuff called dark energy. That, though, is just a name. Its effects can be seen, but its nature is obscure. The balance—about 22%—is a third substance known as dark matter. The data from WMAP confirm this mixture, because “ordinary” matter and dark matter should have affected the harmonics of the sound waves in the early universe in different ways, and that is precisely what seems to have happened.

Like the nature of dark energy, the nature of dark matter is unknown. But unlike dark energy, there are several ideas about what it might be, and one of them is the subject of a second paper, in *Physical Review Letters*, by Peter Biermann of the University of Bonn, in Germany, and Alexander Kusenko, of the University of California, Los Angeles.

Dark matter was first detected in the 1930s, thanks to its gravitational effects on ordinary, visible matter. It is defined by gravity because that is the only way that it interacts—it has no electric charge, and does not feel the strong and weak forces that bind atomic nuclei together.

At the moment, no particles with that property are known, though several are hypothesised. Dr Biermann and Dr Kusenko think that one in particular of these hypothetical particles—known as a sterile neutrino—will turn out to be the main constituent of dark matter. Sterile neutrinos differ from ordinary neutrinos (electrically neutral particles produced in abundance by the nuclear reactions that power the sun) because ordinary neutrinos feel the weak nuclear force, while sterile ones do not. If Dr Biermann and Dr Kusenko are right about sterile neutrinos forming the bulk of dark matter, that would clear up several puzzles about the universe.

One of these is the speed with which the first stars formed. Stars form most easily from molecular hydrogen, but for the first few million years, most hydrogen would have been ionised into protons and electrons. Dr Biermann and Dr Kusenko, though, reckon that sterile neutrinos would occasionally give off X-rays of exactly the right energy to catalyse the formation of hydrogen molecules, and thus—eventually—of stars.

Another piece of evidence for sterile neutrinos comes from supernovas. These leave behind a dense object known as a pulsar, which forms from the core of the exploding star. Pulsars are often ejected from a supernova at high velocity, meaning, in effect, that they have had a huge sideways kick. Existing physics provides no plausible explanation for this, but if sterile neutrinos do exist then they would be formed in supernovas and ejected in a way that could give just such a kick.

Sterile neutrinos could even explain the prevalence of matter over antimatter in the universe—one of reality's most puzzling aspects, since the models suggest that matter and antimatter should have been formed in equal amounts. They would do this by “stealing” a property called lepton number from the primordial cosmic soup. Existing theory requires lepton number to be conserved (that is, neither created nor destroyed). If it isn't, the symmetry between matter and antimatter breaks down. Obvious, really.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Mobile phones

A text a day...

Mar 24th 2006
From The Economist print edition

The medical uses of mobile phones show they can be good for your health

WHAT impact can mobile phones have on their users' health? Many people worry about the supposed ill effects caused by radiation from handsets and base stations, despite the lack of credible evidence of any harm. But evidence for the beneficial effects of mobile phones on health is rather more abundant. Indeed, a systematic review carried out by Rifat Atun and his colleagues at Imperial College, London, rounds up 150 examples of the use of text-messaging in the delivery of health care. These uses fall into three categories: efficiency gains; public-health gains; and direct benefits to patients by incorporating text-messaging into treatment regimes. The study, funded by Vodafone, the world's largest mobile operator, was published this week.

Using texting to boost efficiency is not rocket science, but big savings can be achieved. Several trials carried out in England have found that the use of text-messaging reminders reduces the number of missed appointments with family doctors by 26-39%, for example, and the number of missed hospital appointments by 33-50%. If such schemes were rolled out nationally, this would translate into annual savings of £256m-364m.

Text messages are also being used to remind patients about blood tests, clinics, scans and dental appointments. Similar schemes in America, Norway and Sweden have had equally satisfying results—though the use of text-message reminders in the Netherlands, where non-attendance rates are low, at 4%, had no effect other than to annoy patients.

Text messages can also be a good way to disseminate public-health information, particularly to groups who are hard to reach by other means, such as teenagers, or in developing countries where other means of communication are unavailable. Text messages have been used in India to inform people about the World Health Organisation's strategy to control tuberculosis, for example, and in Kenya, Nigeria and Mali to provide information about HIV and malaria. In Iraq, text messages were used to support a campaign to vaccinate nearly 5m children against polio.

Finally, there are the uses of text-messaging as part of a treatment regime. These involve sending reminders to patients to take their medicine at the right time, or to encourage compliance with exercise regimes or efforts to stop smoking. The evidence for the effectiveness of such schemes is generally anecdotal, however, notes Dr Rifat. More quantitative research is needed—which is why his team also published three papers this week looking at the use of mobile phones in health care in more detail. One of these papers, written in conjunction with Victoria Franklin and Stephen Greene of the University of Dundee, in Scotland, reports the results of a trial in which diabetic teenagers' treatment was backed up with text messaging.

Diabetes needs constant management, and requires patients to take an active role in their treatment by measuring blood-sugar levels and administering insulin injections. The most effective form of therapy is an intensive regime in which patients adjust the dose of insulin depending on what they eat. This is more onerous for the patient, but allows for a greater dietary variety. Previous studies have shown that intensive treatment is effective only with close supervision by doctors. Dr Franklin and her colleagues devised a system called Sweet Talk, which sends patients personalised text messages reminding them of the treatment goals they have set themselves, and allowing them to send questions to doctors. The Sweet Talk system was tested over a period of 18 months with teenage patients receiving both conventional and intensive diabetes treatment. A control group received conventional treatment and no text messages.

The researchers found that the use of text-messaging significantly increased “self-efficacy” (the effectiveness of treatment, measured by questionnaire). More importantly, among patients receiving intensive therapy, the level of haemoglobin HbA1c—an indicator of blood-glucose and hence of glycaemic control—was 14% lower than for those in the control group. Since even a 10% decline in HbA1c level is associated with a reduction in complications such as eye and kidney problems, this is an impressive result. It suggests that texting can cheaply and effectively support intensive therapy among teenagers, who often demonstrate poor compliance.

Despite such promising results, Dr Rifat notes, many of the medical uses of text-messaging have not yet been subjected to clinical trials, because they are so new. And even where the benefits are proven, the technology has not been systematically deployed on a large scale. But when it comes to improving outcomes and reducing costs, text messages would seem to be just what the doctor ordered.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Zoology

On the one hand

Mar 23rd 2006
From The Economist print edition

Why some snails are left-handed

IN THE human world, the left-handed seem at quite a disadvantage. Indeed, a whole industry has sprung up to supply this oppressed minority with everything from left-handed computer mice to mugs and boomerangs.

The world of snails, too, has its sinister minority. Hold a snail with the tip of its shell pointing upwards and the opening towards you, and the shell will normally coil away to the right. Less commonly, it will coil to the left. Until now, biologists have been at a loss to explain what advantage these rare reversals in shell-coiling offer. But Gregory Dietl, of Yale University, and Jonathan Hendricks, at Cornell, think they know the answer.

Dr Dietl and Dr Hendricks, who have just published their results in *Biology Letters*, looked at the question by examining fossil sea snails. They studied 1,722 specimens from six different species and found that right-handed snails were far more likely than left-handers, on a per-snail basis, to show evidence of a lethal confrontation with a crab. What they suspect is happening is that left-handed snails avoid the attentions of right-handed crabs because these dexterous crustaceans find it tricky to eat lefties.

To appreciate this theory fully, you need to understand a little about crab table manners. Modern-day right-handed crabs orient their prey with the shell pointing away from their body and the opening on the right-hand side. This allows the crab to insert a large toothlike appendage on its right-hand claw into the opening, thus cracking the snail's shell. The rest of the shell is then rolled towards the tooth in an anticlockwise direction, in order to remove it.

The process is rather like peeling a potato with a right-handed peeler. Peeling in the other direction is awkward. Thus, a left-handed snail presents a right-handed crab with a challenge—and one that it usually cannot be bothered to accept. Indeed, when Dr Dietl and Dr Hendricks tested their hypothesis they observed crabs picking up left-handed snails and then abandoning them. For humans, the equivalent is probably those really annoying pistachio nuts that accumulate at the bottom of the bag. They are simply more trouble to open than they are worth, and are thus likely to be tossed aside.

It all seems to parallel ideas about left-handedness in human cultures. Left-handers enjoy an advantage in some sports, such as tennis. In the past, it is theorised, they enjoyed a similar advantage on the battlefield. But that raises a further question: if left-handedness is beneficial, then why is it so rare? Here, Dr Dietl and Dr Hendricks, like many others before them, admit they are stumped. One possibility is that lefty snails have difficulty mating with their right-handed relations. Here, at least, parallels with humans appear to end.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Civil liberties

Thinking for freedom

Mar 23rd 2006
From The Economist print edition

American civil liberties need to be protected by an emergency constitution, a legal scholar proposes in a thought-provoking new book

Before the Next Attack: Preserving Civil Liberties in an Age of Terrorism
By Bruce Ackerman

Yale University Press; 240 pages; $26. To be published in Britain by Yale University Press on April 28th

Buy it at
Amazon.com
Amazon.co.uk

AP

THE attacks on the World Trade Centre in New York on September 11th 2001 destroyed lives and infrastructure, as well as disrupting the economy, but they did not threaten America's existence as a state. For this reason alone, they cannot be classified as acts of war. Bruce Ackerman, a legal scholar at Yale Law School and a well-known liberal public-policy gadfly, regards this distinction as crucial.

Mr Ackerman does not like what has happened over the past five years. The “war on terror” is overblown rhetoric, he says, and has heralded a dangerous and illiberal power grab by the executive branch. So what should the appropriate response be to an initial attack that cannot be called war, yet is sufficiently disruptive to stop the country from responding quickly enough to prevent a second strike?

Mr Ackerman proposes an “emergency constitution”—one which would actually be enacted through statute rather than the unwieldy constitutional amendment process. Any American citizen or resident alien who fell into the category of “reasonable suspicion” of terrorist activity could be temporarily detained after a first strike. This would allow the authorities to sweep up suspects, hopefully diminishing the chances of a second attack. The government would then have to release these detainees within 45 days unless it showed enough evidence to clear the higher bar of “probable cause” that is required in a standard criminal case. Those released would receive financial compensation.

Under this plan, the Senate could then declare a post-attack state of emergency—including a suspension of the writ of habeas corpus, as happened during the American civil war—as long as it did so with an escalating majority every two months. A simple majority would suffice at first, then approval by 60% of the Senate after two months, 70% after another two months, and so on. This idea has precedents; as Mr Ackerman points out, both Poland and South Africa have some version of a super-majority requirement for emergency legislation.

Mr Ackerman also analyses the Supreme Court's record since the attacks, which he sees as mixed, especially on the writ of habeas corpus, and he proposes a reasonable post-disaster plan on government continuity. But it is the twin pillars of his “emergency constitution” that will cause the most debate. Civil libertarians will reject his ideas as an infringement of the constitution, while his broadsides against the Bush administration will not win him admirers on the right. Politics aside, though, the book still falls short in two respects.

First is the inherent contradiction between the two proposals. Congress could continually reauthorise the state of emergency while toughening the 45-day detention rule—or throw out the limit altogether. Under this scenario, Congress could, in theory, pass a bill allowing indefinite detention as long as a super-majority approved. Mr Ackerman does not indicate whether one takes priority over the other or whether there is a way to square this circle. More broadly, he fails to draw clear lines around which civil liberties would remain inviolable regardless of the super-majority in Congress. Instead, he assumes rather optimistically that public vigilance will relax once the threat of attack diminishes, and Congress will react accordingly.

Mr Ackerman also glosses over the fact that vigorous protection of civil liberties is a political issue as much as a legal one. He calls for Congress to give more power to whichever party is in the minority, which is laudable but inconceivable in this age of political polarisation. The courts too can play a critical role, but that role becomes circumscribed when one party controls both the executive and legislative branches and Congress is willing to give the White House an easy ride.

To take one example, earlier this month the Republican-controlled Congress in effect gave the administration a green light on domestic spying without a warrant, in contravention of a 1978 law that regulates foreign intelligence surveillance. That this one example occurred more than four years after the terrorists struck—and not within the 60-day window that Mr Ackerman proposes—suggests that an “emergency constitution” can take shape in ways that are far subtler and more durable than Mr Ackerman has outlined.

Before the Next Attack: Preserving Civil Liberties in an Age of Terrorism.
By Bruce Ackerman.
Yale University Press; 240 pages; $26. To be published in Britain by Yale University Press on April 28th

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

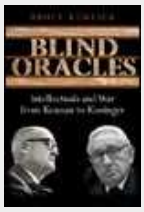
About sponsorship

American foreign policy (1)

Point men

Mar 23rd 2006
From The Economist print edition

Blind Oracles: Intellectuals and War from Kennan to Kissinger
By Bruce Kuklick



Princeton University Press; 264 pages; $29.95 and £18.95

Buy it at
Amazon.com
Amazon.co.uk

GEORGE KENNAN, the philosopher-diplomat who died last year, famously proposed that what American foreign policy needed was a council of wise men, not elected politicians. Kennan failed to appreciate, of course, that foreign policy during the cold war was already a profoundly elitist affair. Power was concentrated in the executive branch, while a handful of think-tank strategists and academics developed the theories—deterrence, limited war and flexible response—that later became the template for policymakers.

The most famous policy shop was RAND, an air force think-tank staffed by civilians, including such iconic figures as Bernard Brodie and Albert Wohlstetter. The group's influence reached its zenith under President Kennedy, who brought in the “brain trust” that managed the Cuban missile crisis in 1962—and then took America down the path to war under Lyndon Johnson.

Bruce Kuklick's “Blind Oracles” works hard to rub off the intellectual gloss that many of these men have since enjoyed. In his brief sketches, he finds a pattern of common failings. Their approach to strategy was at times so ignorant of history, he says, that it verged on the parochial. Rather than trying to unearth the real motives behind other nations' behaviour—American-Japanese economic rivalry in East Asia in the 1930s, for example—they emphasised the risk of “surprise” attacks such as that on Pearl Harbour in 1941. Many of them also grossly overestimated the Soviets' strength in the late 1950s, which is what led to the hype about the “missile gap”.

In essence, most of these men were conventional thinkers who used their models and equations to please their political masters. The defence secretary, Robert McNamara, was one famous example, but he was hardly alone. To be sure, there was also a dissenting minority of strategists—Kennan and Hans Morgenthau chief among them—who as classic “realists” held a more nuanced, pessimistic view of the limits of American power. But Morgenthau was never in government and Kennan saw his influence wane after he helped craft the strategy of containment in the late 1940s.

Mr Kuklick also tries to tear down some of the famous lessons of the Cuban missile crisis, arguing that its subsequent misinterpretation helped lead to the Vietnam war. As he sees it, the president's “Ex-Comm” group of advisers overlooked a key development that initially prompted Moscow to send the missiles to Cuba: signals from America that it would allow West Germany to acquire atomic weapons. Nor were the Ex-Comm debates all that brilliant; if anything, recently released tapes suggest they were often meandering and banal.

Finally, Mr Kuklick argues that it was not Kennedy's secret 11th-hour offer to withdraw American missiles from Turkey that persuaded the Soviets to draw back from the brink. Instead, he cites fresh research suggesting that Nikita Khrushchev, having recognised America's nuclear superiority, had already decided to back off.

All this will provoke the scholars who have long argued over the lessons of the crisis, and will continue to do so for many years to come. But Mr Kuklick's larger point is that many “Randians” emerged vindicated by the experience. As they saw it, the crisis showed that America was able to control the drift towards war through limited escalation. Indeed, two years later, Thomas Schelling, another RAND strategist, hailed America's robust response in the Gulf of Tonkin in 1964 as effective signalling of American resolve to the North Vietnamese.

Only Henry Kissinger, who was not a RAND insider, receives qualified praise from Mr Kuklick for turning a strategic concept into somewhat effective policy—namely, diminishing the role of ideology in the cold-war confrontation so that America could better manage the great-power relationships and extract itself from the Vietnam war. But he did so only when America had already recognised that it had no choice but to leave Indochina.

Mr Kuklick's secondary point—that scholars in government are inevitably seduced by politics—still has resonance today, even if he is not the first to make it. Then again, it is less relevant than it might have been 40 years ago.

Today's theoreticians and practitioners of strategic studies have long parted ways, a recent case in point being the strong and unified opposition of American political scientists to the Iraq war—opposition which also proved to be wholly ineffectual.

Blind Oracles: Intellectuals and War from Kennan to Kissinger.
By Bruce Kuklick.
Princeton University Press; 264 pages; $29.95 and £18.95

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

American foreign policy (2)

Money talks

Mar 23rd 2006
From The Economist print edition

TRYING to destabilise the economies of one's enemies is a long-standing tactic of warfare. In 1470, a Milanese duke, Galeazzo Sforza, counterfeited the currency of Venice to try and weaken his opponents there. Britain faked colonial currencies in America in 1775 in an effort to sap that rebellion. Germany used the same tactic on Britain during the second world war, counterfeiting hundreds of millions of pounds sterling to try and undercut the British economy.

Benn Steil and Robert Litan, two economists at the Council on Foreign Relations and the Brookings Institution respectively, have combed history for nuggets such as these to create a highly readable account of an important, if potentially dry, subject: how international capital flows have been and are still used as instruments of foreign policy. While much ink has been spilled elsewhere on dissecting the effectiveness of trade and aid in foreign affairs, “Financial Statecraft” focuses on the less-studied world of capital flows, financial sanctions, foreign debt underwriting and currency unions.

From the war on terror to the Latin American debt crisis, many examples exist of financial statecraft at work. The risks of this interdependence were evident in the Asian financial crisis of 1997, which provided fuel for growing anti-Americanism, transnational crime, inter-ethnic conflict and terrorism across the region. It also meant that America's allies in South-East Asia had less money to spend on defence, to the advantage of both China and North Korea.

Financial Statecraft: The Role of Financial Markets in American Foreign Policy
By Benn Steil and Robert E. Litan

Yale University Press; 208 pages; $38 and £25

Buy it at
Amazon.com
Amazon.co.uk

What makes “Financial Statecraft” particularly useful for non-economists and policymakers, as well as Wall Street executives and historians alike, is the authors' willingness to be prescriptive about finance in public policy.

They offer observations about what works; countries that have pursued dollarisation, for example, have on the whole done well. They admit that dollarisation is not a practical solution for all countries. But the general principle—adoption of one among the most traded international reserve currencies—can benefit not only those nations themselves but also their trading partners and political allies.

The authors' conclusions may strike economists as obvious, but this is a useful, accessible book for lay readers seeking an understanding of the important role that capital flows play in the making of foreign policy.

Financial Statecraft: The Role of Financial Markets in American Foreign Policy.
By Benn Steil and Robert E. Litan.
Yale University Press; 208 pages; $38 and £25

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BOOKS & ARTS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

London's Bankside

The city's other shore

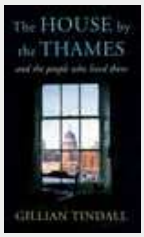
Mar 23rd 2006
From The Economist print edition

BARELY 250 metres separate London's north and south banks, but the psychological distance is much greater. Bankside, the district opposite St Paul's Cathedral, has long been a dumping ground for the city's waste. In the Renaissance, it was associated with fish, prostitutes and actors. In the 1940s, city planners sited a giant power station there—out of mind if not quite out of sight.

Bankside has enjoyed just two moments in the sun. The first was in the 18th century, after the shipping trade had taken off but before the vast south London slums appeared. The second, which began in the 1990s and continues today, is a credit to the rejuvenating effects of art and architecture. Crowds flock over the new Millennium Bridge to visit the Globe Theatre (opened near to, although not on, the site of the one Shakespeare knew) and Tate Modern, an art gallery that was carved out of the old power station in 2000.

Gillian Tindall tracks the fall and rise of the neighbourhood in an unusual way—by focusing on a single house, 49 Bankside. Neither remarkable for its architecture nor for its history, which is less illustrious than tour guides claim, 49 Bankside was built soon after 1710, when it became, in turn, a smart residence for coal merchants, an office, a boarding-house, a derelict husk and eventually, coming full circle, once again a private home.

The House by the Thames and the People Who Lived There
By Gillian Tindall



Chatto & Windus; 258 pages; £20

Buy it at
Amazon.com
Amazon.co.uk

The approach is successful in proportion to how much is known about the house's inhabitants. Before the 20th century, records are simply too thin, and the traces that remain are not scintillating. The Sells, who owned the house for much of the industrial era, were the sort of Victorian worthies whose lives revolved around the parish vestry. Good works, though, rarely make for good copy. Things pick up in the 1930s, when the house was briefly occupied by Anna Lee, a starlet. The author tracked her down in 2003; she was living in Beverly Hills, having built a second career on the marathon American soap opera “General Hospital”. She remembered the house fondly; her sister recalled being escorted home by policemen, as the neighbourhood was thought to be dangerous.

At times, “The House by the Thames” abandons number 49 and becomes an orthodox history of Bankside. That is to the good. Local history is, and has always been, unfashionable, but Ms Tindall is one of its greatest practitioners. One charming sketch is of the ferryman John Taylor, who probably lived in the neighbourhood a century before the house was built. A controversialist, a defender of indefensible monopolies and a bad poet, he was the ancestor of the London taxi driver.

Another inhabitant of a self-publicising bent was Ludvig Munthe, who owned 49 Bankside in the mid-20th century. He seems to have been responsible for the claim that Christopher Wren lived in the house during the building of St Paul's Cathedral. The claim is erroneous, as are more ambitious bids to associate Catherine of Aragon and even Shakespeare with the house. But it is possible that Mr Munthe's fancy helped stay the wrecking ball, preserving an 18th-century gem on London's other shore.

The House by the Thames and the People Who Lived There.
By Gillian Tindall.
Chatto & Windus; 258 pages; £20

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The return of Sidney Lumet

An old maestro

Mar 23rd 2006 | LOS ANGELES
From The Economist print edition

Making his best film at 81

SIDNEY LUMET, who made his feature-film debut with “12 Angry Men” nearly half a century ago, is back with a surprising comedy about the longest Mafia trial in American history.

It took 21 months for federal prosecutors in New York state to present their case against the Lucchese family, disreputable citizens from neighbouring New Jersey, who were accused of criminal conspiracy for assorted rackets. Much of the dialogue of “Find Me Guilty” comes from the trial transcript, which grew until it spilled out of the courtroom where the case was tried.

That overcrowded room, where the jurors have to crane their necks to see the defendants, a literal mob, is a metaphor for the American justice system. It allows Mr Lumet to orchestrate wide shots and ensemble acting with a master's hand, creating a world that teems with imprisoned life like a Brueghel painted inside a cigar box.

The star of this circus, a good-natured hood named Jackie DiNorscio (Vin Diesel), refuses to become a government witness after he is stuck with a 30-year sentence for selling cocaine. He also refuses the services of a lawyer—quite reasonably, given the outcome of his earlier trial. Warning him about the risks of representing himself, Judge Finestein (Ron Silver) quotes the old saw about having a fool for a client, which certainly applies here, because Jackie is a fool for love. He tells the drug-addled cousin who shoots him at the beginning of the film that he loves him even as the deed is being done. And he loves his co-defendants, even though they view him as a loose cannon who could get them locked up for life.

No one will ever think of Mr Diesel as just another action hero after his performance as Jackie, who imposes his own idea of justice on the court: act from the heart, don't rat on your friends. He leads a strong cast that includes Peter Dinklage as the smartest—and smallest—of the army of defence lawyers, Annabella Sciorra as Jackie's ex-wife, Linus Roache as the driven prosecutor and Alex Rocco as a sour gang boss who is immune to Jackie's charm.

At nearly 82, the Prospero of this tempest in a teapot, Mr Lumet, is as subversive as any aspiring indie film-maker. It is a delight to watch him working his magic once again.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

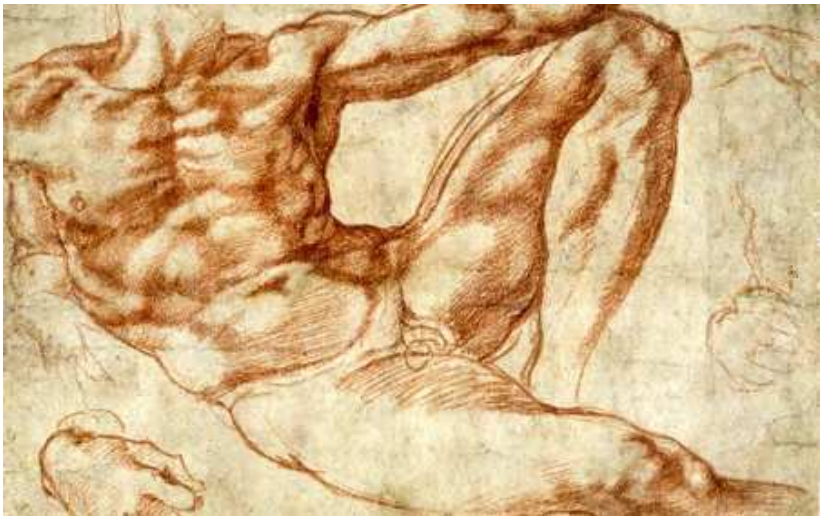
Michelangelo's drawings

Heaven on earth

Mar 23rd 2006
From The Economist print edition

A magnificent show brings the Renaissance master's spirit back to life

British Museum



MICHELANGELO was so afraid that his drawings would reveal the secrets of his art that he hid them from all but a close circle of intimates and had many of them burned before his death. The Renaissance master would be deeply shocked by a new exhibition at the British Museum, for it delivers squarely on its promise of bringing the viewer into intimate contact with his creative genius.

This show—the first in a generation—is possible only because Michelangelo's drawings had become collectors' items even during his lifetime. Not that many became available. In order to preserve the uniqueness of his drawing, the artist refused to have his compositions engraved. Furthermore, as the most celebrated artist of his day—three biographies were written in his lifetime—he was, in effect, pre-booked for years doing papal commissions. Despite this, around 600 sheets of his drawings survive and the British Museum displays 90 of them by joining three of the greatest collections of Michelangelo drawings: its own and those of the Ashmolean Museum in Oxford and the Teylers Museum in Haarlem in the Netherlands.

The show presents drawing as the lifeblood that flows through all of Michelangelo's work—sculpture, painting and architecture. As the curator, Hugo Chapman, says: “We wanted to tell his life through drawings—in them we can get a sense of all of his great projects and understand him as a man. It is through his drawings that he expresses his ideas, his emotions and his faith.”

Michelangelo Buonarroti's long life (1475-1564) spanned an age of great discoveries—from the voyage of Columbus to the excavation of Graeco-Roman antiquities. It is tempting, therefore, to think of him as a cartographer of the human body, breaking new ground in the way he charts the human figure. “In his early drawings of bathers and battles and the sketch-books for the Sistine Chapel,” Mr Chapman says, “he always wants to push your eye around the human form, to contort it to show you more than you could ever see. Because he is a sculptor, a painter and an architect, he sees everything in three dimensions. [It is] as though he has put the human body on a spindle and is turning it back to front in one view.”

Because of this, the viewer has a real sense of Michelangelo's fingers running over the body in an extraordinarily tactile way. Whether a quick chalk sketch or a highly finished pen-and-ink drawing that seems to knead over the rippling contours of the flesh, the workings of his mind and hand are immediately perceptible. Michelangelo's eyes—and those of the viewer—imagine how the light will hit the body, how its full corporeal weight can be translated into paint and marble. Over and over again he seems to be working through the idea of what it means to be incarnate—to move or suffer, fly or fall—through his study of the human form. Faces barely appear. Landscapes too are rare, as are clothes or any kind of background. The body alone conveys emotional and spiritual life.

The reason for this seems to lie in part with Michelangelo's ambition to rival the great artists of antiquity and in part with his particular approach to his religion. When he was a young man in Rome at the end of the 15th century, the Belvedere Torso—an ancient fragment of a heroic male sculpture—was a touchstone for artists. Michelangelo seems to have incorporated it into his own visual language: so often in the drawings here, he starts at the muscular torso, shaping the core of the body, and only then moving outward. He was among the first to see the ancient Hellenistic sculpture of the Laocoon when it was excavated in Rome in 1506. Its writhing forms of a man and his sons gripped by sea serpents seem to add a new dimension of violence to Michelangelo's knotted scenes of wrestling figures, and particularly to his sketches of warrior angels beating sinners out of heaven in the Last Judgment.

Michelangelo clearly believed in Hell. In the religious drawings on display here, his artistic and spiritual credo is worked out in a highly personal way. His studies for the Last Judgment illustrate what was controversial in his time —that everybody looks the same and only the angels can distinguish the saved from the damned. For Michelangelo, who took his faith seriously, life was about being on the right side of this divide.

Yet as he grew older, the artist became increasingly anxious about his own fate. He was influenced by the Lutheran reformation, which saw the death on the cross as the key moment of Christ's life. For Michelangelo, obsessed with the heroic male form, this moment presented a vital artistic challenge: should he show man as God or God as man? In one image the supernatural Christ is so alive that he seems to be bursting off the cross. But the show's last three drawings, done at the end of his life, present a haunting meditation on death. These expressive, mournful works, their blurred forms smudged by the artist's fingers, drag God's body down to earth. It is through this graphic requiem that Michelangelo's humanity is most clearly displayed—in art, at least, he has gained eternal life.

“Michelangelo Drawings: Closer to the Master” is at the British Museum, London, until June 25th.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Lennart Meri

Mar 23rd 2006
From The Economist print edition

Lennart Meri, a former Estonian president, died on March 14th, aged 76

Reuters

Get article background

FATE has not always been kind to the Estonians. Long ruled by Swedish kings, German noblemen or Russian tsars, they did not manage to establish a nation-state for themselves until 1918, when they seized their independence in the aftermath of the Russian revolution. Freedom was short-lived. In 1940, Estonia was annexed by the Soviet Union. German and then a further dose of Soviet occupation followed, until independence was once again declared, in 1991. Fate was then more benevolent, not least in providing the Estonians with a father figure in the shape of Lennart Meri, the most engaging leader that a Baltic mini-state of 1.4m people could wish for. As foreign minister and later as president, Mr Meri helped to put Estonia back on the map of Europe.

Mr Meri's father had been an Estonian diplomat, which was tantamount in Soviet eyes to being a criminal. Accordingly, he was dispatched to Moscow in 1941 and imprisoned in the Lubyanka. His family were deported to Siberia, Lennart becoming, at the age of 12, first a lumberman and then a potato-peeler.

Some Estonians later thought that both Meris must have collaborated. The family's exile in Siberia had been a brief five years, whereas most Estonians similarly deported had languished there for twice as long, and many never came back. Yet Mr Meri's father returned from Moscow to work as a driver and translator of Shakespeare, while Lennart moved up the Soviet establishment, starting out as a theatrical producer, then turning to writing and making films, and eventually becoming a Merited Writer of the Estonian Soviet Socialist Republic. He was allowed to travel, and not just all over the Soviet Union but to Finland—an unusual privilege. Although he never claimed to have been a dissident, the accusations of collaboration troubled him to the end.

His interests were catholic, ranging from foreign affairs and Central Asia to broadcasting and gadgetry. Perhaps his best work was his anthropological research on the Estonians' cousins, the Finno-Ugric tribes of Russia. He liked uncomfortable trips to distant places and would proudly describe how, in a tight spot, he had once eaten his horse. In easier moments, he would translate such books as Graham Greene's “Our Man in Havana”.

In 1989, Mr Meri founded a cultural institute that acted as an unofficial foreign ministry to represent his people's cause abroad, where the very idea of a reborn Estonia, let alone one that might join the European Union and NATO, still seemed fantastical. Most outsiders, conscious of the large Russian-speaking minority in Estonia, saw the

Balts' struggle as a dangerous sideshow that might wreck Mikhail Gorbachev's attempts to reform the Soviet Union. Mr Meri argued otherwise, forcefully, charmingly, endlessly, in any of the five foreign languages he spoke so well.

His skills, though, were not limited to advocacy. In 1990, as foreign minister of what even a *perestroika* Kremlin still regarded as Soviet Estonia, he hooked up a Finnish mobile phone to an antenna in his garden, creating his government's first independent link to the outside world. He thus risked being on the next train back to Siberia. He chucked out the works of Lenin that he found in his new office, and locked the hotline telephone to the Kremlin in a cupboard. “It rings sometimes, but I don't answer it,” he said.

As president from 1992 to 2001, Mr Meri was much older than his colleagues in the youthful government elected under the slogan of “cleaning house”. But his liveliness, jokes and disrespect for rules made him seem much younger than his age. Meetings scheduled to take minutes lasted for hours of amusing, erudite conversation. His staff despaired. But the government slashed the bureaucracy, tore down trade barriers and brought in a flat tax and a currency board, all helping to make Estonia one of the stars of eastern Europe.

Even as president, Mr Meri never lost his theatrical sense. Arriving back from abroad to find that, despite repeated complaints, the national airport's lavatories were still in a state of squalor, he summoned a press conference in the urinals to lambast the authorities. Other characteristics were less likeable. Incapable of punctuality, he would simply telephone the airport and order planes to wait. Fellow passengers just had to lump it.

Leaving his mark

Inevitably, the stories grew: had he really made a point by marking an antique globe in the White House? Yes, he had. Did he really tell George Bush senior: “George, you don't have a Russia policy”? No, he averred, adding obliquely that such tales had to be saddled like horses, and ridden for all they were worth.

That was typical, for making the most of opportunities was always one of his skills. His speeches on big state occasions were masterly lectures against laziness, complacency and dishonesty. He could also be a skilful negotiator, notably in 1994 when he drank Russia's president, Boris Yeltsin, into an acquiescent stupor at talks in the Kremlin. That secured a deal on the full withdrawal of Russian soldiers from Estonia. Chiefly, however, he will be remembered as an unusually amiable and cultivated politician who stood firm against Russia at a crucial moment.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Mar 23rd 2006
From The Economist print edition

Ben Bernanke, the new chairman of the Federal Reserve who presides over his first interest-rate decision next week, has some fresh **inflation** figures to ponder. Consumer prices rose by 3.6% in the year to February. Excluding energy and food, they increased by 2.1%. Producer prices were up by 3.7%.

Industrial production in **America** increased by 0.7% in February, after falling in January. This left output 3.3% higher than the year before. American industry is now running at 81.2% of full capacity, slightly above its long-run average of 81%. Construction, however, is lagging, and housing starts dropped by 7.9% in February to an annual rate of 2.12m homes.

In the **euro area**, industrial production was flat in January, but 2.5% higher than a year earlier. Labour costs, including wages and benefits, increased by 2.4% in the year to the fourth quarter. In France, they rose by 3.3%.

The **euro area** ran a deficit in its trade in goods with the rest of the world in January, for the fourth month in the past six. The trade balance was €10.8 billion ($13.1 billion) in the red, following a €700m gap in December. During all of 2005, however, the euro zone accumulated a surplus of €23.3 billion.

In **Britain**, consumer prices rose by 2% in the year to February, right on the Bank of England's inflation target.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Output, demand and jobs

Mar 23rd 2006
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2006	2007	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.7	Q4	+ 1.9	+ 3.1	+ 3.3	+ 1.3	Q3	+ 1.9	Q4	5.2	Feb	5.1
Austria	+ 2.1	Q4	+ 2.8	+ 2.1	+ 1.9	+ 1.5	Dec	+ 3.3	Dec	5.0	Feb	5.1
Belgium	+ 1.5	Q4	+ 2.4	+ 2.1	+ 1.9	+ 2.7	Jan	+ 2.0	Dec	12.4	Feb†	12.7
Britain	+ 1.8	Q4	+ 2.4	+ 2.1	+ 2.5	− 1.3	Jan	+ 2.1	Feb	5.0	Jan‡	4.7
Canada	+ 2.9	Q4	+ 2.5	+ 3.1	+ 2.8	+ 2.0	Dec	+ 4.9	Dec	6.4	Feb	7.0
Denmark	+ 3.7	Q4	+ 0.3	+ 2.8	+ 2.3	+ 1.1	Jan	+ 5.0	Jan	5.0	Jan	6.1
France	+ 1.2	Q4	+ 0.9	+ 1.9	+ 2.0	+ 0.1	Jan	− 0.3	Jan	9.6	Jan	10.1
Germany	+ 1.0	Q4	nil	+ 1.8	+ 1.2	+ 3.2	Jan	+ 1.7	Jan	11.3	Feb§	11.9
Italy	+ 0.1	Q3	+ 1.1	+ 1.3	+ 1.2	+ 1.0	Jan	+ 1.3	Dec	7.5	Sep	7.9
Japan	+ 4.0	Q4	+ 5.4	+ 2.9	+ 2.4	+ 2.1	Jan	− 0.7	Jan	4.5	Jan	4.5
Netherlands	+ 1.6	Q4	+ 3.9	+ 2.2	+ 1.9	− 0.9	Jan	+ 2.9	Dec	6.1	Feb††	6.5
Spain	+ 3.5	Q4	+ 3.9	+ 3.1	+ 2.7	+ 5.3	Jan	− 0.9	Jan	8.4	Jan	10.1
Sweden	+ 2.9	Q4	+ 2.6	+ 3.3	+ 2.8	+ 5.9	Jan	+ 7.7	Jan	5.6	Feb†	5.7
Switzerland	+ 2.7	Q4	+ 2.1	+ 2.2	+ 1.7	+ 2.8	Q3	+ 3.1	Dec	3.8	Feb†	4.1
United States	+ 3.2	Q4	+ 1.6	+ 3.3	+ 2.8	+ 3.3	Feb	+ 6.1	Jan	4.8	Feb	5.4
Euro area	+ 1.7	Q4	+ 1.2	+ 2.0	+ 1.8	+ 2.5	Jan	+ 0.9	Jan	8.3	Jan	8.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.9	Q4	+ 3.7	na	na	+ 1.1	Jan	+ 5.8	Jan	8.1	Feb	9.0
Greece	+ 3.7	Q4	na	na	na	+ 1.5	Jan	+ 2.3	Dec	9.7	Q4	10.4
Iceland	+ 3.6	Q4	na	na	na	na		na		1.6	Jan†	3.0
Ireland	+ 4.8	Q3	+ 1.3	na	na	+ 9.9	Jan	+ 9.0	Jan	4.5	Feb	4.3
Luxembourg	+ 3.1	Q1	na	na	na	+ 8.3	Dec	+ 2.6	Jan	4.8	Jan	4.3
New Zealand	+ 2.0	Q3	+ 0.2	na	na	− 2.7	Q3	+ 3.0	Q4	3.6	Q4	3.6
Norway	+ 2.5	Q4	+ 1.0	na	na	+ 3.8	nil	+ 6.6	Jan	4.2	Jan**	4.5
Portugal	+ 0.7	Q4	+ 0.4	na	na	+ 2.4	Jan	+ 3.7	Jan	8.0	Q4†	7.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Nov-Jan; claimant count rate 2.9% in Feb. §EU harmonised rate 9.1% in Jan. ††Dec-Feb. **Nov-Jan.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Prices and wages

Mar 23rd 2006
From The Economist print edition

% change on year ago

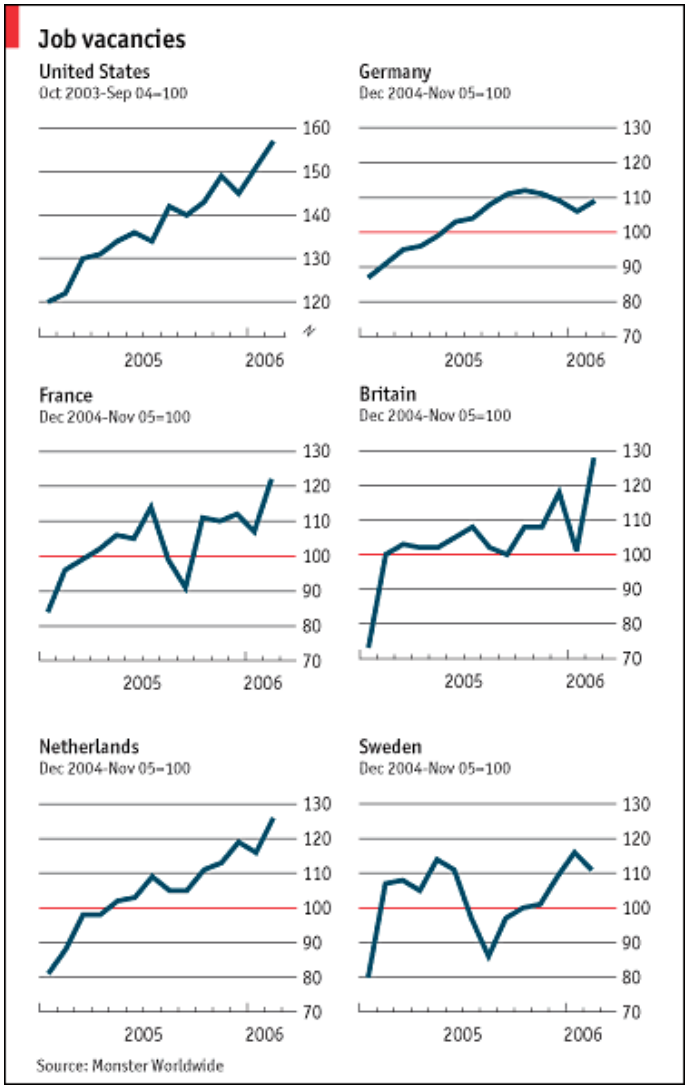
	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 2.8	Q4	+ 2.6	+ 2.9	+ 2.7	+ 4.8	Q4	+ 8.2	+ 5.3	Q4	+ 2.9
Austria	+ 1.2	Jan	+ 2.9	+ 2.0	+ 1.8	+ 1.8	Feb	+ 4.6	+ 2.7	Feb	+ 2.1
Belgium	+ 2.4	Feb	+ 2.6	+ 2.2	+ 1.9	+ 3.5	Jan	+ 5.1	+ 2.3	Oct	+ 2.4
Britain	+ 2.0	Feb*	+ 1.6	+ 1.9	+ 1.9	+ 2.9	Feb	+ 2.7	+ 3.5	Jan†	+ 4.2
Canada	+ 2.2	Feb	+ 2.1	+ 2.1	+ 2.2	+ 2.2	Jan	+ 3.7	– 0.2	Dec	+ 1.7
Denmark	+ 2.1	Feb	+ 1.3	+ 1.9	+ 1.9	+ 4.3	Feb	+ 3.5	+ 2.9	Q4	+ 2.9
France	+ 1.9	Feb	+ 1.6	+ 1.7	+ 1.6	+ 3.7	Jan	+ 2.9	+ 3.3	Q4	+ 3.0
Germany	+ 2.1	Feb	+ 1.8	+ 1.6	+ 2.3	+ 2.9	Feb	+ 3.8	+ 0.8	Dec	+ 1.4
Italy	+ 2.1	Feb	+ 1.9	+ 2.1	+ 1.9	+ 4.7	Jan	+ 4.5	+ 2.3	Dec	+ 3.3
Japan	+ 0.5	Jan	– 0.1	+ 0.3	+ 0.6	+ 2.9	Feb	+ 1.3	– 0.6	Jan	nil
Netherlands	+ 1.1	Feb	+ 1.6	+ 1.5	+ 1.5	+ 6.3	Jan	+ 4.7	+ 1.6	Feb	+ 0.6
Spain	+ 4.0	Feb	+ 3.3	+ 3.3	+ 2.8	+ 6.3	Jan	+ 4.8	+ 2.5	Q4	+ 2.7
Sweden	+ 0.6	Feb	+ 0.7	+ 1.4	+ 1.9	+ 4.9	Feb	+ 2.8	+ 3.4	Dec	+ 2.0
Switzerland	+ 1.4	Feb	+ 1.4	+ 1.1	+ 1.2	+ 1.5	Feb	+ 1.7	+ 0.9	2004	+ 1.4
United States	+ 3.6	Feb	+ 3.0	+ 2.9	+ 2.3	+ 3.7	Feb	+ 4.5	+ 3.5	Feb	+ 2.6
Euro area	+ 2.3	Feb	+ 2.1	+ 2.1	+ 2.1	+ 5.3	Jan	+ 3.9	+ 2.4	Q4	+ 2.4
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.9	Feb	+ 0.2	na	na	+ 5.3	Feb	+ 2.2	+ 3.5	Q4	+ 4.3
Greece	+ 3.2	Feb	+ 3.1	na	na	+ 9.3	Jan	+ 3.3	na		na
Iceland	+ 4.5	Mar	+ 4.7	na	na	+ 3.9	Feb	+ 8.1	+ 8.6	Feb	+ 6.7
Ireland	+ 3.3	Feb	+ 2.2	na	na	+ 2.7	Jan	– 0.4	+ 3.5	Q3	+ 4.7
Luxembourg	+ 3.0	Feb	+ 2.2	na	na	+ 3.3	Jan	+19.3	– 0.1	Dec	+ 0.8
New Zealand	+ 3.2	Q4	+ 2.7	na	na	+ 6.5	Q4	+ 3.4	+ 3.1	Q4	+ 2.5
Norway	+ 2.6	Feb	+ 1.0	na	na	+21.0	Feb	+14.4	+ 3.1	Q4	+ 3.9
Portugal	+ 2.8	Feb	+ 2.2	na	na	+ 5.9	Feb	+ 4.0	+ 0.2	Jan	– 1.5

*RPI inflation rate 2.4% in Feb. †Nov-Jan.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Job vacancies

Mar 23rd 2006
From The Economist print edition



One gauge of strength in the labour market is the number of vacancies. There were 3.9m job openings in America at the end of January 2006, according to the Bureau of Labour Statistics, 17% more than a year earlier. But finding such numbers for Europe is difficult. Monster Worldwide, an online job directory, tracks the number of help-wanted adverts posted on websites, including its own, in France, Germany, the Netherlands, Sweden and Britain. Its European employment index has gained 23 points in the year to February. Some of this gain may be due to newspaper adverts migrating online, but it also suggests a pick-up in recruiting. Monster's index in America rose by 29% in the year to February. According to a similar measure from the Conference Board, there were 1.33 online adverts for every 100 workers in February, down from 1.44 a month earlier.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Money and interest rates

Mar 23rd 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Mar 22nd 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 6.4	+ 8.1	Jan	5.59	5.85	5.19	5.34	5.72	6.39
Britain	+ 6.2	+12.0	Feb	4.55	4.91	4.41	4.30	4.77	5.12
Canada	+ 9.1	+ 6.9	Jan	3.82	2.51	3.96	4.22	4.51	5.34
Denmark	+29.2	+24.0	Jan	2.80	2.25	3.28	3.70	3.74	5.19
Japan	+ 5.5	+ 1.7	Feb	0.04	0.02	0.56	1.74	1.41	1.80
Sweden	+ 1.7	+10.1	Jan	1.95	1.96	2.83	3.51	3.77	3.47
Switzerland	+ 1.4	+ 3.8	Feb	1.21	0.75	1.69	2.35	2.29	2.38
United States	+ 0.4	+ 8.0	Feb	4.79	2.90	4.73	4.70	4.60	5.65
Euro area†	+10.2	+ 7.6	Jan	2.74	2.14	3.16	3.61	3.65	4.19

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.72%, Japan No.277 1.73%. Central bank rates: US fed funds 4.50%, ECB refinancing 2.50%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Economist commodity price index

Mar 23rd 2006
From The Economist print edition

2000=100

	Mar 14th	Mar 21st*	% change on one month	% change on one year
Dollar index				
All items	153.4	155.6	+ 0.1	+12.5
Food	133.8	133.5	– 3.2	+ 0.5
Industrials				
All	178.7	184.2	+ 3.5	+26.8
Nfa†	149.1	146.6	– 1.7	+11.5
Metals	194.9	204.7	+ 5.7	+33.9
Sterling index				
All items	133.3	135.0	– 0.2	+22.3
Euro index				
All items	118.0	119.0	– 1.5	+22.9
Yen index				
All items	167.2	169.0	– 1.5	+25.5
Gold				
$ per oz	547.55	549.85	– 0.9	+27.5
West Texas Intermediate				
$ per barrel	62.88	60.20	– 1.0	+10.9

*Provisional. †Non-food agriculturals.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Stockmarkets

Mar 23rd 2006
From The Economist print edition

Market indices

	Mar 22nd	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	4,974.8	4,974.8	4,708.8	+ 1.4	nil	+ 5.6	+ 3.6
Austria (ATX)	4,075.9	4,158.6	3,682.4	+ 1.1	- 2.0	+11.1	+13.9
Belgium (Bel 20)	3,978.0	3,978.0	3,573.9	+ 0.8	nil	+12.1	+14.9
Britain (FTSE 100)	6,007.5	6,007.5	5,618.8	+ 0.7	-13.3	+ 6.9	+ 8.8
Canada (Toronto Composite)	11,970.7	12,085.6	11,272.3	- 0.7	- 1.0	+ 6.2	+ 6.4
Denmark (OMXCB)	393.2	393.2	362.0	+ 1.0	nil	+ 6.9	+ 9.5
France (SBF 250)	3,659.7	3,659.7	3,327.6	+ 1.3	-16.6	+10.9	+13.6
(CAC 40)	5,194.8	5,194.8	4,748.3	+ 1.3	-25.0	+10.2	+12.9
Germany (DAX)*	5,932.3	5,932.3	5,334.3	+ 0.6	-26.4	+ 9.7	+12.4
Italy (S&P/MIB)	38,519.0	38,602.0	35,652.0	+ 0.1	-23.1	+ 7.9	+10.6
Japan (Nikkei 225)	16,495.5	16,747.8	15,341.2	+ 1.1	-57.6	+ 2.4	+ 3.4
(Topix)	1,686.4	1,713.5	1,572.1	+ 1.2	-41.5	+ 2.2	+ 3.2
Netherlands (AEX)	469.0	469.0	431.5	+ 1.0	-33.1	+ 7.4	+10.0
Spain (Madrid SE)	1,292.8	1,292.8	1,156.8	+ 1.0	nil	+11.8	+14.6
Sweden (Affarsvarlden Gen)	324.0	324.0	287.3	+ 2.2	-19.1	+10.4	+13.4
Switzerland (Swiss Market)	8,064.0	8,064.0	7,583.9	+ 0.6	- 4.1	+ 6.3	+ 7.6
United States (DJIA)	11,317.4	11,317.4	10,667.4	+ 1.0	- 3.5	+ 5.6	+ 5.6
(S&P 500)	1,305.0	1,307.3	1,248.3	+ 0.2	-14.6	+ 4.5	+ 4.5
(NASDAQ Comp)	2,303.4	2,331.4	2,205.3	- 0.4	-54.4	+ 4.4	+ 4.4
Europe (FTSEurofirst 300)†	1,377.5	1,377.5	1,277.1	+ 0.7	-19.2	+ 8.0	+10.7
Euro area (FTSE Euro 100)†	1,188.2	1,188.2	1,078.9	+ 0.8	-23.4	+ 9.1	+11.8
World (MSCI)‡	1,337.3	1,340.1	1,259.1	+ 0.5	- 7.7	+ 6.3	+ 6.3
World bond market (Citigroup)††	622.5	638.9	613.5	+ 0.5	- 2.6	+ 0.4	+ 0.4

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade, exchange rates and budgets

Mar 23rd 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2006	2007	Exchange rate trade-weighted† 2000=100 Mar 22nd	year ago	Currency units per $ Mar 22nd	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 14.2	Jan	− 42.1	Q4	− 5.4	− 4.0	114.5	115.4	1.39	1.29	2.43	1.68	1.19	+ 1.0
Austria	− 1.9	Dec	+ 0.5	Dec	+ 0.2	+ 0.2	104.9§	105.9	0.83	0.77	1.45	–	0.71	− 2.0
Belgium	+ 12.9	Jan	+ 8.2	Sep	+ 2.2	+ 2.3	106.6§	107.9	0.83	0.77	1.45	–	0.71	nil
Britain	−119.3	Jan	− 40.6	Q3	− 2.3	− 2.3	97.5	99.5	0.57	0.53	–	0.69	0.49	− 3.1
Canada	+ 57.8	Jan	+ 25.2	Q4	+ 2.0	+ 1.4	124.4	117.8	1.17	1.21	2.04	1.41	1.00	+ 1.3
Denmark	+ 9.4	Jan	+ 7.4	Jan	+ 2.9	+ 2.7	106.2	106.6	6.17	5.72	10.8	7.46	5.28	+ 2.8
France	− 29.2	Jan	− 39.7	Jan	− 1.3	− 1.1	107.3§	108.8	0.83	0.77	1.45	–	0.71	− 3.2
Germany	+197.8	Jan	+111.0	Jan	+ 3.9	+ 3.9	108.7§	110.4	0.83	0.77	1.45	–	0.71	− 3.9
Italy	− 14.6	Jan	− 26.5	Jan	− 1.5	− 1.4	106.9§	108.3	0.83	0.77	1.45	–	0.71	− 4.3
Japan	+ 89.0	Jan	+162.7	Jan	+ 3.7	+ 3.5	82.2	88.0	117	106	204	141	–	− 6.5
Netherlands	+ 39.0	Jan	+ 39.8	Q4	+ 5.2	+ 5.1	107.4§	108.7	0.83	0.77	1.45	–	0.71	− 1.6
Spain	− 96.6	Dec	− 85.5	Dec	− 6.9	− 7.0	105.2§	106.1	0.83	0.77	1.45	–	0.71	+ 0.3
Sweden	+ 19.6	Jan	+ 21.8	Q4	+ 6.7	+ 6.3	96.1	99.7	7.75	7.01	13.5	9.37	6.63	+ 1.2
Switzerland	+ 7.0	Feb	+ 49.3	Q3	+13.1	+12.4	105.2	107.2	1.30	1.19	2.28	1.57	1.11	− 1.6
United States	−792.6	Jan	−804.9	Q4	− 6.8	− 6.8	86.6	82.1	–	–	1.75	1.21	0.86	− 3.7
Euro area	+ 18.1	Jan	− 35.4	Dec	− 0.1	nil	117.0	118.8	0.83	0.77	1.45	–	0.71	− 2.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 10.4	Jan	+ 5.3	Jan	na	na	108.1§	109.4	0.83	0.77	1.45	–	0.71	+ 2.1
Greece	− 34.2	Dec	− 18.1	Jan	na	na	103.6§	105.1	0.83	0.77	1.45	–	0.71	− 4.5
Iceland	− 1.6	Jan	− 2.6	Q4	na	na	106.8**	95.0	71.5	61.3	125	86.4	61.2	+ 2.0
Ireland	+ 39.6	Jan	− 3.7	Q3	na	na	112.1§	114.7	0.83	0.77	1.45	–	0.71	− 0.9
Luxembourg	− 4.8	Dec	+ 3.5	Q3	na	na	106.6§	107.9	0.83	0.77	1.45	–	0.71	− 2.3
New Zealand	− 4.9	Jan	− 9.6	Q4	na	na	126.1	136.4	1.60	1.39	2.79	1.93	1.37	+ 5.3
Norway	+ 50.6	Feb	+ 43.7	Q3	na	na	110.2	107.4	6.58	6.28	11.5	7.95	5.63	+ 15.3
Portugal	− 23.0	Dec	− 16.6	Jan	na	na	104.6**	104.3	0.83	0.77	1.45	–	0.71	− 6.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, January average. ‡OECD estimate. **IMF, November average.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

About sponsorship

Official reserves

Mar 23rd 2006
From The Economist print edition

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Mar 23rd 2006
From The Economist print edition

Argentina's GDP increased by 9.1% in the year to the fourth quarter. It grew by 9.2% in 2005 as a whole, its fastest rate for 13 years.

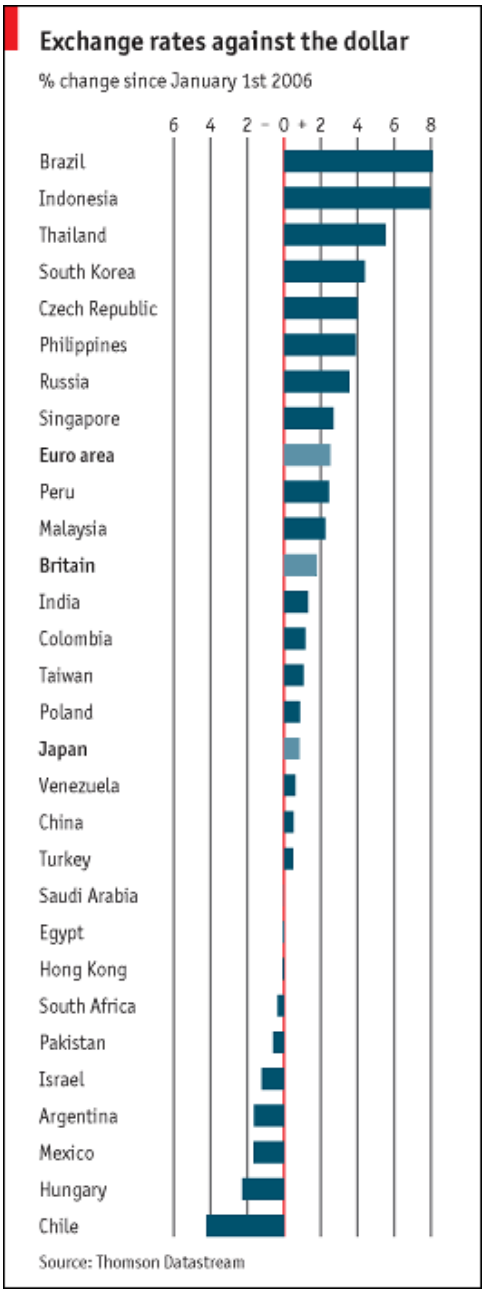
Brazil's current-account surplus widened to $13.5 billion in the year to February. Over the same period, **Pakistan's** trade deficit swelled to a record $10.1 billion. In 2005, Egypt's trade deficit increased to $11.1 billion, from $9.3 billion in 2004.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Exchange rates against the dollar

Mar 23rd 2006
From The Economist print edition

Brazil's real has risen by more than 8% against the dollar since the start of this year, the biggest appreciation among the emerging economies regularly tracked in this section. Argentina, Mexico and Chile, by contrast, have seen their currencies fall against the greenback this year. Most Asian currencies have strengthened. China's yuan has been allowed to rise, but only by 0.5%.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economy

Mar 23rd 2006
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q4	+16.2	Feb	+ 0.9	Feb	+102.6	Feb	+128.5	H1	818.9	Dec
Hong Kong	+ 7.6	Q4	+ 5.9	Q4	+ 1.6	Feb	– 9.7	Jan	+21.0	Q3	125.7	Feb
India	+ 7.6	Q4	+ 8.3	Jan	+ 4.4	Jan	–38.0	Feb	–18.3	Q3	136.6	Feb
Indonesia	+ 4.9	Q4	–15.4	Jan	+17.9	Feb	+29.1	Jan	+ 0.7	Q3	33.3	Jan
Malaysia	+ 5.2	Q4	+ 2.6	Jan	+ 3.2	Feb	+26.8	Jan	+18.7	Q3	70.7	Jan
Pakistan	+ 8.4	2005†	+19.3	Sep	+ 8.0	Feb	–10.1	Feb	– 3.7	Q4	9.8	Jan
Philippines	+ 6.1	Q4	+ 0.1	Dec	+ 7.6	Feb	– 3.7	Dec	+ 2.9	Sep	18.0	Feb
Singapore	+ 8.7	Q4	+ 1.3	Jan	+ 1.2	Feb	+30.6	Feb	+33.2	Q4	120.2	Feb
South Korea	+ 5.3	Q4	+ 6.4	Jan	+ 2.3	Feb	+19.3	Feb	+15.7	Jan	215.9	Feb
Taiwan	+ 6.4	Q4	+ 4.4	Jan	+ 1.0	Feb	+ 7.6	Feb	+16.4	Q4	257.0	Feb
Thailand	+ 4.7	Q4	+ 5.8	Jan	+ 5.6	Feb	– 7.5	Jan	– 2.3	Jan	51.7	Jan
Argentina	+ 9.1	Q4	+ 8.6	Feb	+11.5	Feb	+11.3	Jan	+ 5.4	Q4	18.7	Jan
Brazil	+ 1.4	Q4	+ 3.2	Jan	+ 5.5	Feb	+45.5	Feb	+13.5	Feb	56.3	Jan
Chile	+ 5.2	Q3	+ 7.7	Jan	+ 4.1	Feb	+ 9.7	Feb	– 0.2	Q3	16.1	Feb
Colombia	+ 5.8	Q3	+ 0.9	Dec	+ 4.2	Feb	+ 1.4	Jan	– 1.7	Q3	14.9	Feb
Mexico	+ 2.7	Q4	+ 6.0	Jan	+ 3.7	Feb	– 6.0	Jan	– 5.7	Q4	76.7	Jan
Peru	+ 4.4	Jan	+ 4.1	Jan	+ 2.7	Feb	+ 5.2	Jan	+ 1.0	Q4	13.0	Feb
Venezuela	+10.2	Q4	+13.5	Dec	+12.5	Feb	+31.5	Q4	+25.4	Q4	23.9	Dec
Egypt	+ 5.2	Q1	+ 4.0	2005†	+ 3.4	Jan	–11.1	Q4	+ 1.8	Q3	21.3	Feb
Israel	+ 4.8	Q4	+ 8.4	Jan	+ 3.1	Feb	– 8.7	Feb	+ 2.4	Q4	28.0	Feb
Saudi Arabia	+ 6.5	2005‡	na		+ 1.2	Dec	+84.6	2004	+51.9	2004	26.0	Jan
South Africa	+ 4.5	Q4	+ 5.6	Jan	+ 4.0	Jan	– 4.1	Jan	–10.3	Q3	20.2	Feb
Czech Republic	+ 6.9	Q4	+15.1	Jan	+ 2.8	Feb	+ 1.7	Jan	– 2.6	Q4	29.4	Feb
Hungary	+ 4.3	Q4	+11.0	Jan	+ 2.5	Feb	– 3.4	Jan	– 8.7	Q3	19.8	Feb
Poland	+ 4.2	Q4	+10.1	Feb	+ 0.7	Feb	– 2.9	Jan	– 4.5	Jan	41.3	Jan
Russia	+ 7.0	Q4	+ 1.0	Feb	+11.1	Feb	+124.3	Jan	+86.6	Q4	197.9	Feb
Turkey	+ 7.0	Q3	– 4.5	Jan	+ 8.2	Feb	–43.9	Jan	–23.4	Jan	52.9	Jan
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+10.5	Q4	+12.1	Jan	+ 4.6	Feb	– 2.4	Dec	– 1.3	Jan	1.9	Jan
Latvia	+10.5	Q4	+11.2	Jan	+ 6.1	Feb	– 3.0	Jan	– 2.0	Jan	2.3	Jan
Lithuania	+ 8.2	Q4	na		+ 3.4	Feb	– 3.8	Jan	– 1.9	Jan	4.0	Jan
Slovakia	+ 7.5	Q4	+ 7.7	Jan	+ 4.4	Feb	– 2.7	Jan	– 3.0	Nov	15.1	Jan
Slovenia	+ 5.1	Q4	+ 5.5	Dec	+ 2.2	Feb	– 1.7	Jan	– 0.2	Jan	8.1	Dec

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Financial markets

Mar 23rd 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Mar 22nd		Dec 30th 2005	
	Mar 22nd	year ago	Mar 22nd	% a year		one week	in local currency	in $ terms
China	8.03	8.28	14.0	2.40	1,359.8	+3.7	+ 11.4	+ 12.0
Hong Kong	7.76	7.80	13.6	4.41	15,642.8	-0.5	+ 5.2	+ 5.1
India	44.5	43.7	77.7	6.59	10,841.4	+0.4	+ 15.4	+ 16.8
Indonesia	9,088	9,406	15,876	13.69	1,302.3	+4.7	+ 12.0	+ 21.3
Malaysia	3.69	3.80	6.45	3.47	921.9	-0.2	+ 2.5	+ 4.9
Pakistan	60.1	59.4	105	9.00	11,278.5	+8.5	+ 18.0	+ 17.4
Philippines	51.1	54.2	89.3	7.13	2,184.7	+2.7	+ 4.2	+ 8.1
Singapore	1.62	1.64	2.82	3.44	2,489.3	-0.4	+ 6.0	+ 9.1
South Korea	974	1,009	1,701	4.26	1,309.8	-1.8	- 5.0	- 1.4
Taiwan	32.6	31.4	56.9	1.68	6,391.3	-2.0	- 2.4	- 1.5
Thailand	38.9	38.7	68.0	4.95	724.4	-2.3	+ 1.5	+ 6.8
Argentina	3.07	2.92	5.37	9.63	1,793.1	-0.3	+ 16.2	+ 14.4
Brazil	2.16	2.74	3.77	16.54	37,850.0	-1.0	+ 13.1	+ 22.4
Chile	532	587	930	4.68	9,864.6	nil	+ 7.2	+ 3.1
Colombia	2,263	2,385	3,953	5.99	10,822.9	+0.8	+ 13.8	+ 15.0
Mexico	10.9	11.2	19.0	7.31	19,598.1	+3.1	+ 10.1	+ 7.8
Peru	3.34	3.26	5.84	4.05	5,869.0	+1.9	+ 22.2	+ 25.5
Venezuela	2,535§	2,944§	4,428	10.82	29,257.6	-2.3	+ 43.5	+ 46.4
Egypt	5.74	5.80	10.03	8.56	57,382.2	+3.7	+ 3.7	+ 3.6
Israel	4.66	4.34	8.15	5.27	863.7	+1.8	+ 4.3	+ 3.0
Saudi Arabia	3.75	3.75	6.55	5.17	15,681.5	+0.5	- 6.2	- 6.2
South Africa	6.34	6.19	11.1	7.20	19,991.5	+1.5	+ 10.5	+ 10.6
Czech Republic	23.7	23.2	41.4	2.09	1,539.9	+1.2	+ 4.5	+ 8.6
Hungary	220	190	384	6.41	22,510.3	+3.7	+ 8.3	+ 5.3
Poland	3.24	3.18	5.66	4.14	38,890.7	+1.8	+ 9.2	+ 9.8
Russia	27.7	27.7	48.5	12.00	1,408.8‡	+2.3	+ 20.8	+ 25.2
Turkey	1.34	1.36	2.35	14.36	44,328.8	+2.5	+ 11.4	+ 12.1
EM (MSCI)*	1.00	1.00	1.75	na	770.5	-0.4	+ 9.1	+ 9.1
EMBI+†	1.00	1.00	1.75	na	377.5	nil	+ 2.4	+ 2.4

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.